CANADA

Investment rules of the world

DLA PIPER

About

At DLA Piper, we have one of the largest finance and projects teams in the world with more than 600 dedicated lawyers and an established local law firm network. We share knowledge and skills in debt instruments, debt securities, funds, derivatives and portfolios, as well as energy, infrastructure and other projects, across Europe, the Middle East, Africa, Asia Pacific and the Americas.

When and wherever we work for you on finance and investment deals and projects, you can rely on our international platform; we are backed by the network and resources of one the largest and most-connected business law firms in the world.

We enjoy being part of your team, bringing experience across sectors, borders and financial products, supporting you on first-of-a-kind deals, in new markets and to grow.

With global perspective, we can help you to realize your financial strategy in whichever markets you do business.

Investment Rules of the World

With input from across our global network, this guide covers key legal topics for different financial activities and projects and gives you an overview of the points you may consider when initially looking at financing or investing in particular jurisdictions. Please contact us if you would like to discuss any legal issues or solutions for your business. We also welcome your feedback about this guide via investmentrules@dlapiper.com.

Canada

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on the issuance of debt securities in all Canadian jurisdictions.

The rules relating to the issuance of debt securities are the same as those relating to the issuance of equity. Debt securities may not be issued to the public unless a prospectus has been filed with the securities commission of each province and territory in which the securities are proposed to be sold. Debt securities may be issued without filing a prospectus by way of a private placement.

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What are common issuing methods and types of debt securities?

Debt securities may be publicly issued by filing a prospectus, or by way of private placement pursuant to an offering memorandum or a term sheet.

Debt securities are usually issued under a trust indenture entered into between the issuer and an indenture trustee that acts as a representative of the subscribers.

Common types of debt securities include bonds, secured and unsecured notes, convertible and non-convertible debentures, and asset-backed securities.

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What are the differences between offering debt securities to institutional / professional or other investors?

Prospectus requirements do not create a distinction between institutional/professional or other investors. Investors that meet the prescribed eligibility criteria as an 'accredited investor' or a 'permitted client' may purchase debt securities offered by way of private placement.

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When is it necessary to prepare a prospectus?

Any offering of debt securities requires a prospectus, unless an exemption from the prospectus requirement applies.

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What are the main exchanges available?

Most debt securities in Canada are not listed on a securities exchange but trade over-the-counter through alternative trading systems, such as:

- CanDeal;
- CBID/CBID Institutional; and
- Market Axess.

The two principal stock exchanges in Canada both list debt as well as equity securities:

- Toronto Stock Exchange (TSX); and
- TSX Venture Exchange (TSXV).

Issuers seeking to list on either the TSX or TSXV must complete a listing application and various listing requirements.

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Is there a private placement market?

Yes, in Canada there is an active private placement market for both bank and non-bank issued debt securities.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers filing a prospectus are responsible for statements made in prospectuses and any misleading statement, omissions or failure to make full, true and plain disclosure could result in civil and criminal liability. Further, purchasers of securities offered by a prospectus that contains a misleading statement also have a right of rescission and a right to bring a civil action against the issuer as well as the directors, the underwriters, the auditors etc.

Issuers must also ensure that the issuance of debt securities does not contravene any covenants made to other lenders or the terms and conditions of any agreement to which the issuer is a party.

Investing in debt securities

Where debt securities are issued under a trust indenture, the indenture trustee usually has the authority to permit certain changes to the terms and conditions without the consent of the security holders. Further, significant changes may be made with the approval of a majority of security holders.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

The establishment and operation of a fund and the offering of fund securities is subject to regulation under the securities legislation and the oversight of the securities commission of each province. Private equity funds and hedge funds are only indirectly regulated unless they file a prospectus; however, such funds may only sell their securities in compliance with available prospectus exemptions, and must comply with applicable dealer registration requirements.

Each of Canada's ten provinces and three territories has its own securities laws, administered by a local securities regulatory authority. However, in a growing number of areas, including investment fund regulation, the rules have been largely harmonised across the 13 jurisdictions.

The key regulatory instruments that apply to offering fund securities and operating a fund, among other things are:

- National Instrument 81-101 – Mutual Funds Prospectus Disclosure (NI 81-101) that regulates projects disclosure requirements for mutual funds;
- National Instrument 81-102 – Investment Funds (NI 81-102) that sets out core investment restrictions and fundamental operational requirements;
- National Instrument 81-105 – Mutual Funds Sales Practices (NI 81-105) that regulates the sale of mutual funds;
- National Instrument 81-106 – Investment Fund Continuous Disclosure (NI 81-106) that sets out continuous disclosure requirements for investment funds; and
- National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103) that regulates registration requirements and the activities of registrants.

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What are common fund structures?

Common forms of funds include:

- **Open-ended retail funds** – are also referred to as mutual funds and are pooled funds that generally issue securities or units continuously.
- **Closed-ended retail funds** – are also referred to as non-redeemable investment funds. These typically raise a fixed amount of capital through a public offering and many are listed on capital markets.

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What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Both closed-ended and open-ended funds that wish to sell securities to the public must file a prospectus and comply with continuous disclosure and other applicable regulatory requirements, as well as exchange rules and policies where the securities of the fund are publicly listed. The funds must also comply with applicable registration requirements under NI 31-103.

Foreign funds in many cases will be able to sell its foreign securities to Canadian investors without being registered in Canada, provided the fund:

- sells only to 'permitted clients';
- meets all requisite conditions; and
- complies with certain filing requirements (as set out under NI 31-103).

Institutional/professional funds

Institutional or professional funds are not recognized as a separate category and the offering of securities by an institutional fund would depend entirely on the form of the fund. Where the fund is marketing to the public, it must file a prospectus and comply with continuous disclosure and other applicable regulatory requirements, as well as exchange rules and policies where the securities of the fund are publicly listed. Alternately, as is more often the case, funds targeted at institutional investors do not offer securities to the public and generally offer securities by way of a private placement under a prospectus-filing exemption.

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Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Managing investments is a regulated activity in Canada, and dealers and financial advisors must be registered with the applicable securities commission. Similarly, individuals acting on behalf of registered firms must also be registered under the applicable category.

Investing in funds

Investment in funds is subject to generally the same risks as investment in any other security.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Retail funds can be marketed by registered dealers. Mutual funds are typically distributed to retail investors by either:

- investment dealers; or
- mutual fund dealers.

Exempt market dealers can also market prospectus qualified, open-ended funds to eligible investors under a prospectus exemption. The most common prospectus exemption is the accredited investor exemption. Under this prospectus exemption, securities can be distributed to a purchaser that qualifies as an accredited investor, including:

- an individual who alone or with a spouse has either CA$1 million in financial assets or CA$5 million in net assets;
- an individual who had net income before taxes exceeding CA$200,000 in each of the two most recent calendar years (or CA$300,000 when combined with income of a spouse);
- a Canadian financial institution or Schedule III bank;
- an advisor or dealer;
- the Government of Canada or a jurisdiction of Canada (including crown corporations and agencies);
- a municipality, public board or commission in Canada;
- certain pension funds; and
- certain investment funds.

Institutional investors that are 'permitted clients' may be less relevant for retail funds but are the focus of hedge and non-resident funds.

A firm registered as an investment dealer or mutual fund dealer must generally be a member of a self-regulatory organization. Investment dealers must generally become members of the Investment Industry Regulatory Organization of Canada (IIROC). Mutual fund dealers must generally become members of the Mutual Fund Dealers Association of Canada (MFDA).

Registered dealers, including mutual fund dealers, are subject to 'know your client' (KYC), 'know your product' (KYP) and suitability requirements that are collectively intended to ensure that purchases of securities are not incompatible with the client's circumstances, risk tolerance and investment goals.

Under KYC requirements, dealers must take reasonable steps to establish the identity of a client and to ensure that they have sufficient information to meet their suitability obligation. Under suitability requirements, a dealer must obtain, understand and is expected to explain how a proposed investment is suitable for the client in light of the client's investment needs and objectives, including the client's:

- time horizon for its investments;
- financial circumstances (including net worth, income, current investment holdings and employment status); and
- risk tolerance for various types of securities and investment portfolios, taking into account the client's investment knowledge.

Registrants must conduct their own product due diligence and be able to explain to clients the security's:

- risks;
- key features; and
- initial and ongoing costs and fee.

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Are there any restrictions on managing a fund?

NI 31-103 provides for the registration of persons in connection with trading or advising in securities, investment fund management and other related matters.

The key requirement is registration as an investment fund manager (IFM), which is defined as a person or company that directs the business, operations or affairs of an investment fund. IFMs are subject to a statutory duty to act in the best interests of an investment fund. The regulators considered extending this duty of care to other categories of registrants, however, subsequent to an extensive consultation period, the regulators published a set of proposed amendments which impose new requirements, codify best practices in existing guidance, and clarify the client-registrant relationship. These amendments are expected to come into force on December 31, 2019, subject to receiving required provincial approvals, with industry participants being required to comply over a two-year phased transition period.

An IFM that acts as a portfolio advisor or that distributes securities of its own funds must also register as a portfolio manager (PM) or as an exempt market dealer (EMD), respectively. All registrants, including EMDs, must:

- meet minimum capital and insurance requirements;
- adopt written compliance policies and procedures;
- file periodic reports with the principal securities regulator and maintain certain records; and
- identify, disclose and manage conflicts of interests.

Fund managers must disclose, on a quarterly basis, net asset value (NAV) adjustments. In addition, all registrants must file audited financial statements with the regulators. IFMs of funds that are reporting issuers must comply with the requirements of National Instrument 81-102 (NI 81-102), NI 81-106 and NI 81-107.

Dealers and advisors are subject to best execution requirements under NI 23-101 (Trading Rules) and rules regarding soft dollar arrangements under NI 23-102 (Use of Client Brokerage Commissions).

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

The regulation of derivatives in Canada, like securities, is governed by individual provincial regulators. However, provincial regulators have generally enacted uniform regulations in respect of derivatives, which are substantially similar to those in the US and in the EU, all as part of its G20 commitments following the global financial crisis in 2008.

Dealer registration requirements exist to the extent a party is engaged in the 'business of trading derivatives'. There are a number of indicia to indicate if and when a party is considered a dealer and whether or not they are subject to registration requirements.

Over-the-counter derivatives transactions in some jurisdictions in Canada are treated as trading in securities and are thus subject to securities laws. To be exempt therefrom (pursuant to blanket orders in individual jurisdictions), parties to over-the-counter derivatives transactions must represent that they are of a type of sophisticated counterparty that ensures they are aware of and have adequately assessed the risks associated with these types of transactions. There are a number of criteria included in such blanket orders for purposes of determining a party's ability to trade derivatives relating to the type of entity and net worth of any such individual or entity.

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What are common types of derivatives?

Derivative contracts are entered into in Canada for a range of reasons including foreign exchange, currency, commodity, hedging and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contracts are widely used in Canada:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contract is based on the value of the underlying assets. The main classes of underlying assets seen in Canada are:

- equity;
- interest rates;
- commodities;
- foreign currency; and
- credit events.

Certain types of standardized over-the-counter derivatives, including interest rate swaps and foreign rate agreements, are also subject to mandatory clearing.

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Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-to-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. Canada, in line with the G20 Commitments, has sought in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulation and this has led to substantial compliance costs for market participants. In particular, the new regulations are focused on trade reporting, dealer registration, mandatory clearing and margining to reduce credit and market risk.

In addition, derivatives are subject to normal market and counterparty credit risk and, as a result, are designed solely for sophisticated entities.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending Banks

The operation of domestic and foreign banks is governed by the Bank Act (Canada) which requires that a bank receive authorization to carry on banking activities in Canada. The classification of the bank as a Schedule I Bank (Canadian-owned banks), Schedule II bank (foreign bank subsidiaries) or Schedule III bank (foreign banks operating through branches in Canada) determines which provisions of the Act apply to such bank.

Section 510(1) of the Bank Act (Canada) provides that:

> 'Except as permitted... 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; (c) establish, maintain or acquire for use in Canada an automated banking machine, a remote service unit or a similar automated service, or in Canada accept data from such a machine, unit or service; or (d) acquire or hold control of, or a substantial investment in, a Canadian entity.'

An exemption to section 510(1) is found in section 524(1) of the Act which permits a foreign bank to establish a branch in Canada upon approval from the Minister of Finance.

A foreign bank can avoid the application of the Bank Act (Canada) while making loans to Canadian borrowers by ensuring that the bank's activities in Canada do not amount to engaging in or carrying on business in Canada. This is a question of fact and depends on the circumstances of each individual situation.

Foreign banks may also establish Representative Offices in Canada with the required approval under the Bank Act and may promote the services of the foreign bank and act as a liaison with non-Canadian Offices of the foreign bank, but may not otherwise carry on business.

Borrowing

Borrowers are generally not regulated; however, some regulations apply if the borrower is classified as a consumer, depending on the Province's consumer legislation.

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What are common lending structures?

Lending in Canada can be structured in a number of different ways to include a variety of features depending on the commercial needs of the parties.

A loan can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility).

Syndicated facilities by their nature involve more parties (such as agents and trustees who fulfil certain roles for the finance parties) and are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans are structured to achieve specific objectives (eg term loans, working capital loans, project facilities and letter of credit facilities).

Loan durations

The duration of a loan can vary among:

- a term loan, which is provided for an agreed period of time, usually 3-5 years;
- a revolving loan, which allows for the loan amount to be withdrawn, repaid and redrawn until the maturity date;
- an overdraft, which is provided on a short-term basis to solve short-term cash flow issues; and
- a standby loan, where the lender gives a commitment to advance a specified amount of money on demand or at a future date.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, which means that the lender is obliged to provide the loan if certain conditions are satisfied; or
- uncommitted, which means that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or on scheduled repayment dates (usually meaning the loan is repayable in full at maturity).

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What are the differences between lending to institutional / professional or other borrowers?

Generally, there are no differences between lending to institutional/professional borrowers and other borrowers. There may be additional considerations regarding the taking and enforcing of security for secured loans and execution requirements.

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Do the laws recognize the principles of agency and trusts?

Yes, both principles are recognized as a matter of Canadian law.

For instance, it is possible to appoint an agent to act on behalf of other parties and a trustee to hold rights and other assets on trust for the lenders or secured parties.

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Are there any other notable risks or issues around lending?

Generally

ENFORCEABILITY

Loan agreements and other finance documents are subject to general contractual principles. Enforcement of contracts is subject to applicable bankruptcy, insolvency, moratorium, reorganization and other similar laws relating to or affecting the enforceability of creditors' rights generally, general equitable principles and the discretion of courts in granting equitable remedies.

INTEREST

Except with respect to mortgages on real property and, in Québec, hypothecs subject to the provisions of the Civil Code of Québec, a lender may charge any rate of interest pursuant to the Interest Act (Canada), provided that if the rate of interest is payable at a rate or percentage per day, week, month or for any period less than a year, the lender discloses in the agreement the yearly rate or percentage of interest to which the other rate or percentage is equivalent. If such disclosure is not included in the agreement, no interest exceeding the rate or percentage of 5% per annum is chargeable, payable or recoverable on any part of the principal money. In addition, the Criminal Code (Canada) prohibits the charging of annual interest that exceeds 60%. Any rate above 60% is a 'criminal rate' and is illegal. Debtors may use such a finding as a reason to avoid repayment. 'Interest' is broadly defined under the Criminal Code (Canada) and includes all charges and expenses, including fees, fines, penalties and commissions.

ENVIRONMENTAL ISSUES

Lenders must also be mindful of the various environmental liabilities and obligations that apply under federal, provincial and territorial laws to their debtors. In certain circumstances, these liabilities and obligation can extend to the lender. This can arise if the lender is found to have exercised control or direction over the day-to-day operations or financial management of the debtor or becomes the owner of a contaminated site by foreclosure or similar action.

Specific types of lending

For secured lending to individual debtors, lenders should consider the application of various provincial and territorial legislation which protects the rights of spouses. For more information, see Giving and taking guarantees and security.

Standard form documentation

Loan documents and other finance documents are generally the bank's standard form documentation.

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Are there any other notable risks or issues around borrowing?

Borrowers should consider the risks associated with defaulting under the loan agreements and ancillary documents and the rights of the lender on such default.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to check the constitutional documents of a corporation giving a guarantee or security to ensure it has an express or ancillary power to do so and there are no restrictions on the directors' powers that would be preventative. Canadian creditors generally rely on the legal opinions of debtors' counsel as to capacity and the enforceability of loan agreements and ancillary documents.

In Québec, the Civil Code of Québec provides various obligations pertaining to the right to grant a security, notably depending on whether the grantor is an individual or a business entity.

Insolvency

Guarantees and security may be at risk of being set aside under Canadian insolvency laws and under provincial fraudulent preference /conveyancing laws if the guarantee or security was granted by a corporation within a certain period of time prior to the onset of insolvency. This would be the case if the corporation giving the guarantee or security received considerably less consideration and, as such, the transaction was at an undervalue. Guarantees and security may also be challenged on other grounds relating to insolvency.

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What are common types of guarantees and security?

Common forms of guarantees

Guarantees can take a number of forms. Two common forms are performance bonds and payment guarantees.

PERFORMANCE BONDS

A performance bond describes a financial undertaking used to protect a buyer against the failure of a supplier to deliver goods or perform services in accordance with the terms of a contract. The issuer of the bond undertakes to pay to the buyer a sum of money if the seller fails to deliver the goods or perform the contracted services on time or in accordance with the terms of the contract.

PAYMENT GUARANTEES

A payment guarantee provides that the guarantor will be obligated to pay either all outstanding monies owed under the primary contract or an amount up to a fixed amount if the debtor or obligor fails to make such payments.

Common forms of security

The common types of security agreements are as follows.

GENERAL SECURITY AGREEMENTS (GSAS)

A GSA normally charges all present and after-acquired personal property of the debtor, but can be limited to specific items of personal property and can include a floating or fixed charge against the debtor's interest in real property. In Québec, the equivalent of a GSA is a hypothec which charges present and after-acquired movable property (ie personal property).

PLEDGES

Pledges require debtors to deliver certain assets, such as securities or negotiable instruments, to the creditor.

MORTGAGES

A mortgage charges the real property of the debtor. In Québec, the equivalent of a mortgage is a hypothec which charges immovable property (ie real property).

Additionally, it is possible to grant security over all of the assets of the debtor (which is called in Québec the universality of the assets of the debtor). Granting security over all of a corporation's assets will tend to be achieved by way of a debenture which will include:

- a mortgage over real property (and, in Québec, that would be a hypothec over the universality of all the immovable assets);
- a fixed charge over assets which are identifiable;
- a floating charge over fluctuating and less identifiable assets; and
- an assignment by way of charge over receivables and contracts.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

To be valid, a guarantee needs to be in writing, signed by the guarantor and provided for good consideration.

Consideration for a guarantee is subject to general contractual principles. In the case of a guarantee, the underlying obligations will usually be the consideration for the guarantee and so it is advisable to execute the guarantee at the same time as executing the underlying obligations to avoid any suggestion of past consideration. Often the guarantee is included in the loan agreement and so this should not be an issue. Also, it can be difficult to establish consideration for a guarantee as the primary obligations are between the underlying obligor and beneficiary, for example between the borrower and lender. Guarantees can be executed as deeds to avoid any argument about whether good consideration was provided. Deeds have particular execution requirements which need to be observed.

In Alberta, personal guarantees require compliance with the Guarantees Acknowledgment Act (Alberta). In Saskatchewan, personal guarantees require compliance with The Saskatchewan Farm Security Act (Saskatchewan). Generally, the guarantor needs to appear before a lawyer in Alberta or a lawyer or notary public in Saskatchewan and:

- acknowledge that he or she executed the guarantee; and
- execute the prescribed guarantee certificate in the presence of the lawyer or notary public.

The lawyer or notary public, as applicable, then must complete the prescribed guarantee certificate. Failure to comply with the applicable Act will result in the personal guarantee being unenforceable. In Québec, guarantees or suretyships must comply with the Civil Code of Québec.

In most Canadian jurisdictions, corporate legislation permits a corporation to give financial assistance by way of guarantee or otherwise to any person for any purpose, provided it discloses material financial assistance to its shareholders. In some provinces and territories, the corporation must meet the prescribed insolvency test in order to provide financial assistance to an intercorporate group. Under certain circumstances, creditors and minority shareholders may challenge the granting of a guarantee under the oppression provisions of the applicable corporate legislation.

Giving or taking security

Once granted, security needs to be properly "perfected" before it is valid against third parties. Perfection formalities depend on the location and nature of property subject to the security and can range from having the secured asset delivered to the secured party, registering the security agreement or notice thereof in the applicable provincial registry system, providing notice of the security interest to third parties, or a combination thereof. The registry system and the requirements for registration vary among the provinces and territories. All of the common law provinces have enacted Personal Property Security Acts which have a great deal of similarity in purpose and content. The PPSAs are modelled on the U.S. UCC-9 provisions. Quebec has a comparable regime under the Civil Code of Quebec.

Additionally, the priority of a secured party's security interest may be governed by various provincial and federal laws which deal with the taking, perfecting and enforcing of security interests. The determination of priorities among interests created under the various Acts can be a cumbersome process. Generally, a creditor will conduct searches to ascertain whether there are any secured parties who will have priority over its interests in all provinces and territories in which a debtor carries on business or has assets.

There may also be unregistered interests which may take priority over a secured party, including statutory liens. Statutory liens commonly arise from a debtor's obligation to remit amounts collected or withheld on behalf of the government (eg employee deductions for income taxes, pension plan contributions, goods and services taxes, provincial sales taxes and property taxes). These liens are deemed trusts and are usually not registered in any registry system. As such, they may not be identified through conventional searches. Issues regarding statutory liens typically arise when a debtor becomes insolvent or commences a restructuring under the Bankruptcy and Insolvency Act (Canada) or the Companies' Creditors Arrangement Act (Canada).

For security interests granted by individual debtors, creditors should consider the application of various provincial and territorial legislation which protects the rights of spouses. Such legislation may affect a secured party's ability to enforce its security against a home or homestead. Generally, this risk can be mitigated by receiving the written consent of the spouse of the debtor at the time the debtor executes the security agreement.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

FEDERAL

Bank Act (S.C. 1991, c. 46)

Office of the Superintendent of Financial Institutions Act (R.S.C, 1985, c. 18 (3rd Supp.), Part I)

Financial Administration Act (R.S.C., 1985, c. F-11)

Canadian Securities Administrators (group that co-ordinates securities regulation among the 13 provincial and territorial regulators)

PROVINCIAL

Each province and territory has enacted its own securities legislation and has established a regulatory authority to administer it. Many provinces and territories interpret securities laws in the same manner through the adoption of National and Multilateral Instruments. These National and Multilateral Instruments can be found at each province's or territory's respective securities commission website.

Securities Act (Alberta) and Alberta Securities Commission

Securities Act (BC) and the British Columbia Securities Commission

Securities Act (Ontario) and Ontario Securities Commission

Securities Act (Québec), Derivatives Act (Québec) and the *Autorité des marchés financiers*

Consumer credit

FEDERAL

Financial Consumer Agency of Canada Act (S.C. 2001, c.9)

QUÉBEC

Consumer Protection Act-RSO c.P40

Civil Code of Quebec

Mortgages

FEDERAL

Canada Mortgage and Housing Corporation Act (R.S.C., 1985, c. C-7)

QUÉBEC

In Québec, the equivalent to a mortgage is a hypothec, which is the most common form of securities.

Civil Code of Québec

Regulation No. 29 respecting Mutual Funds Investing in Mortgages (V-1.1, r. 45)

Corporations

FEDERAL

Canada Business Corporations Act

PROVINCIAL

Each province and territory has its own provincial legislation.

Ontario Business Corporations Act

Alberta Business Corporations Act

Business Corporations Act (Québec) and Civil Code of Québec

Funds and platforms

PROVINCIAL (ONTARIO)

National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (Advisors, Dealers, Investment Fund Managers)

National Instrument 81-101 Mutual Fund Prospectus Disclosure

National Instrument 81-102 Investment Funds

National Instrument 81-104 Commodity Pools

National Instrument 81-105 Mutual Fund Sales Practices

National Instrument 81-106 Investment Fund Continuous Disclosure

National Instrument 81-107 Independent Review Committee for Investment Funds

PROVINCIAL (QUÉBEC)

National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (Advisors, Dealers, Investment Fund Managers)

National Instrument 81-101 Mutual Fund Prospectus Disclosure

National Instrument 81-102 Investment Funds

National Instrument 81-104 Commodity Pools

National Instrument 81-105 Mutual Fund Sales Practices

National Instrument 81-106 Investment Fund Continuous Disclosure

National Instrument 81-107 Independent Review Committee for Investment Funds

Other key market legislation

Investment Industry Regulatory Organization of Canada

Mutual Fund Dealers Association of Canada

PROVINCIAL

Multilateral Instrument 91-101 Derivatives: Product Determination

Multilateral Instrument 96-101 Trade Repositories and Derivative Data Reporting

(ONTARIO)

Instruments 91-301 to 94-101

(QUÉBEC)

Instrument 41-101 to 45-513

Derivatives Regulation (I-14.01, r. 1)

Instruments 91-506 to 94-102

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Regulatory authorization

Who are the regulators?

Provincial (Québec)

The *Autorité des marchés financiers* is the regulator of the Québec financial sector, notably in the areas of insurance, securities, derivatives, deposit institutions (other than banks) and the distribution of financial products and services, as well as products and services related to insurance, in both retail and wholesale markets. It is also responsible for any enforcement of market abuse and listing regimes.

Self-regulatory organizations (eg Montréal Exchange) receive certain delegation of powers from the *Autorité des marchés financiers* in order to monitor and supervise the conduct of its members, including development of rules and compliance control in respect of these rules.

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What are the authorization requirements and process?

Provincial (Québec)

Subject to certain exemptions, any firm/person wishing to act as a dealer, advisor or investment fund in Québec must register with the *Autorité des marchés financiers*.

In that regard, the *Autorité des marchés financiers* maintains the Register of firms and individuals authorized to practise.

Certain fees may apply and are payable to the *Autorité des marchés financiers* depending on the type of services and products, or on the type of registration.

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What are the main ongoing compliance requirements?

People who sell or give advice about mutual funds must be registered through the sponsorship of a dealer, with the provincial securities commission in each province where they want to sell mutual funds.

A dealer, or retail distributor, must be registered with the appropriate securities commission(s) and, depending on the jurisdiction and the types of securities the dealer can sell, it may have to be a member of the Mutual Fund Dealers Association (MFDA) or Investment Industry Regulatory Organization of Canada (IIROC). The advisors sponsored by a dealer are also regulated by the MFDA or IIROC, except in Québec where they are regulated by the *Chambre de la sécurité financière*.

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What are the penalties for failure to be authorized?

Provincial (Québec)

Anyone undertaking any regulated activity without being authorized or registered, commits an offence (sometimes criminal) and is liable to be subject to a fine (and in some cases to imprisonment).

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Regulated activities

What finance and investment activities require authorization?

Generally

Foreign investment in certain industry sectors such as telecommunications, transportation, broadcasting and banking will generally require prior approval by the applicable regulatory authority.

INVESTMENT CANADA ACT (CANADA)

Foreign investment in Canada is regulated by the Investment Canada Act (Canada). Non-Canadians who propose to acquire control of an existing Canadian business must either (depending on whether certain prescribed monetary thresholds for the investment are exceeded):

- file a notification prior to the implementation of the investment or within 30 days thereafter; or file an application for review prior to implementation of the investment.

Non Canadians who establish a new Canadian business must file a notification.

With certain exceptions, an application for review triggers a pre-closing waiting period (which may be several weeks or longer), meaning that approval of the Minister of Innovation, Science and Industry is required before the transaction may close. [If the investment involves acquisition of control of a cultural business, approval is required from the Minister of Canadian Heritage.] Such approval will be provided if the relevant Minister is satisfied that the transaction will result in a 'net benefit' to Canada. Investors normally must provide commitments in order to secure such approval.

The federal cabinet, in consultation with the Minister of Innovation, Science and Industry, may also order a review of an investment by a non-Canadian where there are reasonable grounds to believe the investment could be a injurious to national security. Such a review is possible for foreign investments constituting less than an acquisition of control and regardless of financial thresholds. This applies to a non-Canadian that acquires an interest in or establishes a Canadian business or, in certain circumstances, an entity carrying on all or part of its operations in Canada.

COMPETITION ACT (CANADA)

Where the prescribed financial thresholds are exceeded, the parties must notify the Commissioner of Competition (head of the Competition Bureau) about the proposed transaction and observe the prescribed waiting periods. Completion of the transaction cannot take place unless and until the Commissioner issues an Advance Ruling Certificate (ARC) or waives the requirement to notify, or the statutory waiting period has expired.

Before closing and for up to one year thereafter, the Commissioner may challenge a merger of any size where it is likely to lessen or prevent competition substantially. The Commissioner's challenge is made by way of an application to the Competition Tribunal. The Commissioner typically seeks an order to block a merger or to require divestiture of assets. Parties to a merger may voluntarily seek

approval from the Commissioner (in the form of an ARC or "no-action letter") if there are concerns with respect to the competitive impact of the transaction.

INVESTMENT IN REAL PROPERTY

In Alberta, Saskatchewan, Manitoba and Québec, the investment in farm land by non-Canadians is regulated and restricted. Each province has a different definition of who is considered to be a non-Canadian. In Québec, the investment in farm land by non-residents of Québec and foreign-controlled entities is also regulated and restricted.

In Prince Edward Island, the investment in land by non-residents of Prince Edward Island is regulated and restricted.

SECURITIES

Any regulated financial activity in Québec requires an authorization from the *Autorité des marchés financiers*. For instance, any firm providing money or insurance services has to be registered with the *Autorité des marchés financiers*.

Consumer credit

In addition to federal consumer protection laws, each province and territory in Canada has enacted consumer protection legislation. Generally, consumer protections cannot be waived and the prescribed disclosure must be provided to the consumer prior to entering into an agreement with the consumer (eg the total cost of credit or borrowing, as well as any particular fees, must be disclosed to the consumer). Consumer protection laws in some provinces also prohibit clauses that provide that a foreign law governs the consumer agreement or that provide that the consumer is not permitted to bring a class action or be a member of a group bringing a class action.

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Are there any possible exemptions?

The Investment Canada Act (Canada) and the Competition Act (Canada) each contain limited exemptions from the application of the Act.

Generally, the applicable legislation in each of Alberta, Saskatchewan, Manitoba, Québec and Prince Edward Island set forth certain exemptions regarding the investment in farm land or land, in case of Prince Edward Island. If one of the exemptions does not apply, non-Canadians can apply for an exemption or authorization from the regulatory authority responsible for administering the relevant regime.

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Do any exchange controls or other restrictions on payments apply?

There are no exchange controls in Canada and no restrictions on the repatriation of profits (other than requirements relating to withholding tax on dividends etc).

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What are the rules around financial promotions?

Rules

'Financial promotions' is not a concept used in Canada.

Under Canadian securities laws, a distribution of securities may only be made by way of a prospectus that complies with Canadian securities laws and that has been filed with the Canadian securities regulators, unless a prospectus exemption is available. The securities laws of a province of Canada will apply if securities are sold to a purchaser who is resident in such province or to a purchaser who has sufficient connections to such province to trigger the application of its securities laws.

Canada also has anti-spam legislation (Canada's Anti-Spam Law (CASL)). Generally, express opt-in consent is required to send commercial electronic messages (including emails, text messages and other electronic messages) to any person in Canada. There must also be compliance with certain content requirements, including those relating to sender details and unsubscribe requests.

Exemptions

Issuers can offer or issue their securities in a manner that is exempt from the prospectus requirements (under National Instrument 45-106 Prospectus Exemptions). The most commonly used prospectus exemption is the exemption that permits a sale of securities only to investors who qualify as accredited investors under Canadian securities laws. There are also the family-and-friends exemption, employee exemption and the offering memorandum exemption, in addition to others.

Under CASL, there are a few relationships in which there will be implied consent to receive commercial electronic messages, including existing business relationships (ie where the person has made a transaction, an inquiry, an application or a written contract for the purchase or barter of products, goods or services). Emails must still comply with the content requirements, including those relating to sender details and unsubscribe requests.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

The most common types of legal entities are general partnerships, limited partnerships, limited corporations and unlimited liability corporations. Other legal structures available in Canada for businesses include contractual relationships, such as franchises, joint ventures and license agreements.

Limited liability and tax consequences tend to be the main considerations for most businesses when choosing the appropriate means for undertaking financial or investment activity.

PARTNERSHIPS

A partnership generally exists when two or more persons carry on business together with a view to profit. The income and losses of the partnership generally flow through to the partners of the partnership.

In a general partnership, each partner is jointly liable for the debts and obligations of the partnership. In a limited partnership, the general partner is liable for the debts and obligations of the partnership and the limited partners are only liable to the extent of their capital contributions (provided they do not take part in the management or control of the business of the partnership).

CORPORATIONS

Corporations are considered to be separate legal entities. Shareholders of a limited corporation (denoted by Limited or Ltd., Incorporated or Inc., or Corporation or Corp.) have limited liability and shareholders of an unlimited liability corporation (denoted by Unlimited Liability Corporation or ULC) have unlimited liability. Incorporation can be effected at the federal, provincial or territorial level; however, only the provinces of British Columbia, Alberta and Nova Scotia allow for the creation of an unlimited liability corporation.

A corporation incorporated either provincially or federally must be extra-provincially registered in each province where such corporation carries on business. The 'carrying on business' test is specific to each jurisdiction, but typical indicia include whether an entity has any physical presence or assets, resident employees or agents, local phone numbers or traditional advertising activities in the jurisdiction. The registration process in each jurisdiction is relatively straightforward and generally involves some combination of submitting an application, paying a fee, appointing an agent for service, and providing proof of the entity's existence (eg a certificate of status).

Funds

Investment funds tend to take the form of limited partnerships, limited companies and trusts. Persons who act as investment fund managers are generally required to register in the provinces or territories in which the investment fund managers do business. If an investment fund manager does not have a place of business in Canada, it may be exempt from this registration requirement in certain circumstances.

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes.

A non-Canadian entity may conduct business in Canada through a branch office of the non-Canadian entity. The non-Canadian entity will be required to register (with the appropriate authority) as an extra-provincial entity in each province where it carries on business.

Last modified 2 Jan 2020

FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Overview

In Canada, FinTech products and services are continually evolving and commonly include, among others, peer-to-peer (P2P) lending platforms, crowdfunding platforms, virtual credit cards, online lenders, robo advisors (ie algorithm-driven wealth management and advisory services), online money transfer services and the implementation of digital currency initiatives. These new products and services may use artificial intelligence (AI), machine learning, distributed ledger technology or other technologies to offer a compelling service to clients and customers.

Marketplace lending

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes P2P-type structures often operated through an electronic platform provider, crowdfunding platforms that connect investors with companies looking to raise capital (including from retail investors) and various other financing mechanisms.

It is not uncommon for a marketplace lending platform to raise capital from venture capital funds and/or private equity funds or institutional sponsors.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, deposit base or asset pools, deriving an effective funding structure will be particularly important.

A significant issue for any marketplace lender will be navigating the Canadian (and potentially international) regulatory regime(s). For example, depending on the nature of the activities and the manner in which they are conducted, some or all of the following legal regimes, among others, may be relevant to the business:

- securities law (eg robo advisory firms, crowdfunding platforms and P2P lending platforms may all be subject to applicable securities laws);
- consumer protection legislation (this may govern the relationship between the lender and its customers);
- payment processing regulation (either by federal or provincial legislation or industry standards and codes);
- anti-money laundering legislation (including the Proceeds of Crime (Money Laundering) and Terrorist Financing Act);

- privacy legislation; and
- data security legislation.

It is imperative that startup marketplace lenders engage appropriate legal counsel and other advisors to assist in establishing a business structure that is both efficient and regulatory compliant from the outset as this will assist the startup in attracting investment and ensuring it is positioned to reduce potential issues during its growth phase.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate, depending on their software engine, the nature of transactions they are completing or other

unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

There are various definitions of cryptocurrency and many individuals use it in a colloquial sense; however, it can be considered to be a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is currently booming). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer's business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a 'security' for purposes of applicable laws.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper (or an offering memorandum or prospectus if the token offering constitutes an offering of securities) available to potential purchasers. Any person contemplating an ICO should consult with global legal counsel to ensure that they are complying with all applicable laws, including securities laws, sanctions, anti-money laundering, tax and consumer protection legislation.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors' are software tools driven by AI that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform/personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years. Any business contemplating the use of cloud computing must ensure it has appropriate regulatory, privacy and data security procedures in place.

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Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The regulation of financial products and services is a combination of both federal and provincial regimes, which can often be divergent and overlapping.

GENERAL

There is not currently a comprehensive regime which specifically regulates FinTech in Canada. However, a person carrying on business in the area of financial products and services will be required to comply with a variety of banking, securities, consumer protection and privacy laws.

COMPETITION BUREAU OF CANADA'S MARKET STUDY REPORT: TECHNOLOGY-LED INNOVATION IN THE CANADIAN FINANCIAL SERVICES SECTOR

After conducting an 18 month long study which included holding a FinTech workshop for stakeholders, founders and regulators held in February 2017, the Competition Bureau of Canada published its market study report in December 2017. The report set out 30 recommendations for regulators and policy makers. 19 of the recommendations identified specific, technical improvements in the areas of retail and payment systems, investment dealing and advice, P2P lending and equity crowdfunding while 11 of the recommendations focused on how to strike the right balance between regulation and innovation. Some of the broader recommendations that the Competition Bureau had for regulators are as follows:

- Principles based regulation – Regulators should adopt a principles-based approach instead of prescribing exactly how a service must be carried out, which would allow for more flexibility with regards to enforcement as technology continues to change.
- Function focused regulation – Regulators should focus on the function that an entity carries out which will ensure that all entities that perform the same function carry the same regulatory burden and consumers have the same protections when dealing with competing service providers.
- Collaboration – Regulators should encourage collaboration throughout the sector, using mechanisms such as regulatory sandboxes and innovation hubs.
- FinTech Policy Lead – Regulators should identify a FinTech policy lead for Canada in order to facilitate FinTech development to provide industry participations with a one-stop resource for information and encourage greater investment in innovative businesses.
- Access, Harmonization and Review – Regulators should promote greater access to core infrastructure and services, continue their efforts to harmonize regulations across jurisdictions in Canada and continue to review their regulatory frameworks frequently.

CANADIAN SECURITIES ADMINISTRATORS BUSINESS PLAN 2019-2022

In June 2019, the Canadian Securities Administrators (CSA) published the CSA Business Plan 2019-2022, which includes considering the development and adaptation of the regulatory framework to address challenges brought by emerging technologies as one of the strategic goals. This goal consists of (i) identifying emerging regulatory issues which require regulatory action or clarity, and (ii) developing a tailored and effective regulatory resposne.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

Federally-regulated financial instructions (FRFIs) must comply with payment rules and standards set out in the federal Bank Act. The Office of the Superintendent of Financial Institutions (OSFI) regulates, among other things, the payment processing services of FRFIs. FinTech mobile payment providers are not usually FRFIs, and therefore not subject to OSFI oversight. However, FinTech companies are required to comply with various codes of conduct and standards in Canada's payment industry, including the Code of Conduct for the Credit and Debit Card Industry in Canada and the Canadian NFC Mobile Payments Reference Model.

In July 2017, the federal Department of Finance issued a consultation paper entitled 'A New Retail Payments Oversight Framework', which outlined various aspects of a proposed new framework for regulating retail payments. With limited exceptions, the new proposed framework would apply to any payment service provider (PSP) that is engaged in the following payment functions:

- **provision and maintenance of a payment account** – providing and maintaining an account held in the name of one or more end-users for the purpose of making electronic fund transfers;
- **payment initiation** – enabling the initiation of a payment at the request of an end-user;
- **authorization and transmission** – providing services to approve a transaction and/or enabling the transmission of payment messages;

- **holding of funds** – enabling end-users to hold funds in an account held with a PSP until it is withdrawn by the end-user or transferred to a third party through an electronic fund transfer; and
- **clearing and settlement** – enabling the process of exchanging and reconciling the payment items (clearing) that result in the transfer of funds and/or adjustment of financial positions (settlement).

The new oversight framework would only apply to retail payments carried out solely in fiat currencies and not virtual currencies.

The Government of Canada's 2019 Budget "Investing in the Middle Class" included plans to legislate first measures of a new retail payment oversight framework, drawn from the Department of Finance's 2017 consultation paper discussed above. These commitments to legislate include end-use fund safeguarding and operational standard requirements, however new legislation has not yet been published to introduce the aforementioned measures.

PAYMENTS MODERNIZATION

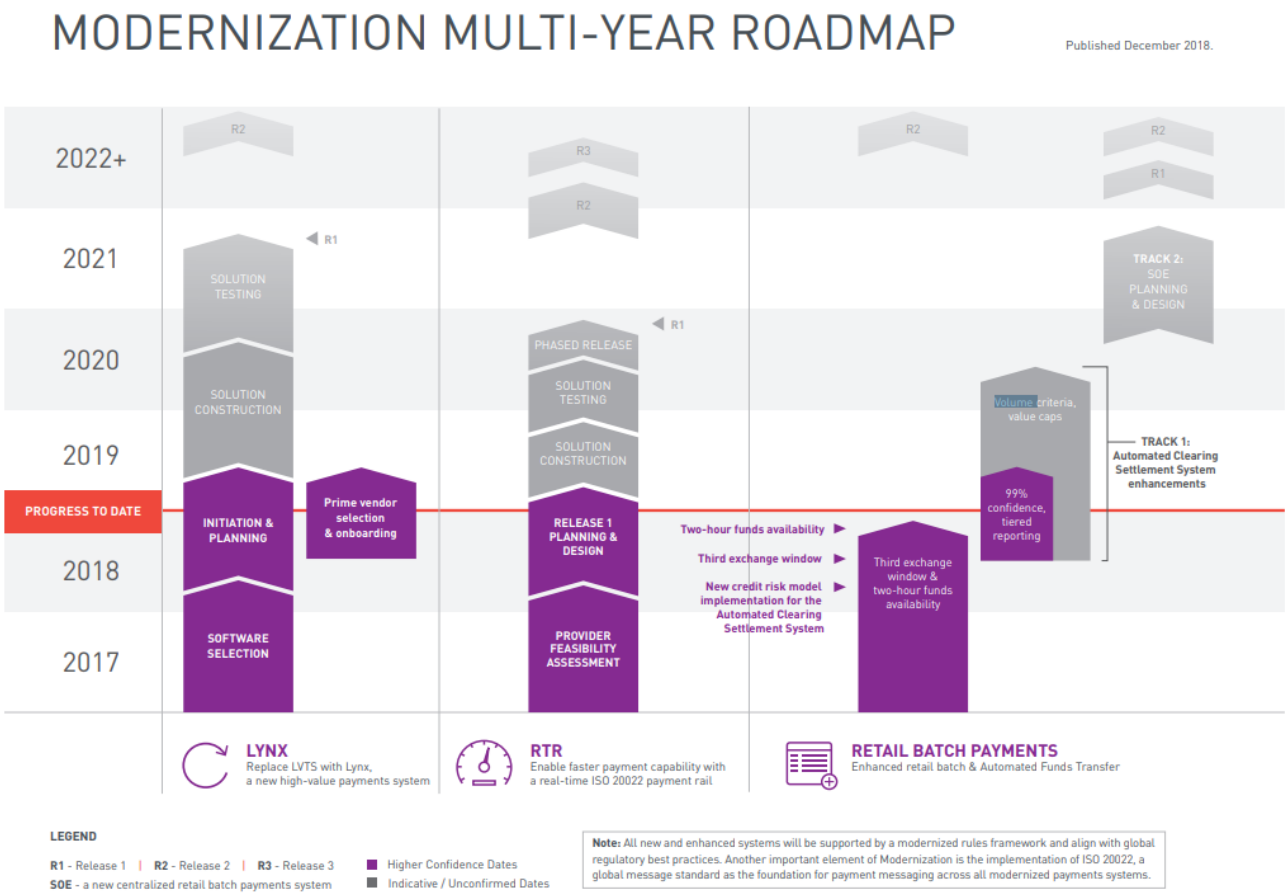
Modernization is a multi-year Payments Canada initiative to modernize the systems and rules that are essential to Canada's payments ecosystem. In April 2016, Payments Canada published the initial Vision for the Canadian Payments Ecosystem (the "Vision") and in December 2016 published an Industry Roadmap & High Level Plan which discusses how Payments Canada and the industry can modernize the Canadian payments ecosystem to advance the Vision. On December 21, 2017, Payments Canada published the Modernization Target State, which provides an in-depth view of the target end state for payment system modernization in Canada, including the infrastructure, rules and standards that will benefit Canadians and businesses from coast-to-coast.

Most recently, on December 19, 2018, Payments Canada published the Modernization Delivery Roadmap 2018 Update (the "Roadmap"). The Roadmap provides an update on Canada's progress on its payments modernization program, which includes implementing a new credit risk model for Canada's retail payment system and enhancing to Automated Funds Transfer. The Roadmap provides revised timelines for the implementation of the modernization initiative.

The Roadmap discusses:

- High-value payments system - Lynx: The appointment of a prime vendor for hosting and system integration services as an additional step to manage risk and effectively deliver on Payments Canada's commitment to meet the highest international security, resiliency and operating standards. The prime vendor will support the end-to-end delivery and operations of Lynx, including oversight of SIA, the application provider for Lynx.
- Real-time rail: Clearer articulation of the release schedule for the new real-time payments system in Canada. The first release (referred to as R1) of Canada's new real-time payments system is a foundational release that will deliver the real-time processing of transactions, real-time deposit and real-time availability of funds. R1 will include an enhanced risk model using collateral pledged through the Bank of Canada to support final and irrevocable real-time payments, which will lower settlement risk and support broadening access to new participants; an alias management capability that allows for the routing of payments using an email address or mobile phone number; the capability to carry additional payment information based on ISO 20022 message standards; and the availability of standardized APIs. Future releases of Canada's new real-time payments rail will build on this foundation, creating opportunities for innovation and competition in the Canadian marketplace.
- Retail batch payments: The prioritization of additional improvements to the current retail batch payments system in advance of progressing to a new, centralized system, which will reduce system risk and support broadening access to members. The additional enhancements to the current system will build on the series of enhancements introduced in 2018. In 2018, modifications were implemented to the existing retail batch payments system, the Automated Clearing and Settlement System (ACSS), that allow Canadian businesses to move funds more frequently and make same day settlements. The delivery date of an enhanced centralized retail batch system has been extended beyond the R1 launch of the Real-Time Rail (RTR) and Lynx. Focus has shifted to the delivery of regulatory enhancements that will reduce system risk including increasing collateral coverage and implementing value caps on individual transactions.

Please see below the Roadmap providing revised timelines for Lynx, the real-time rail and the retail batch payment system.



PEER-TO-PEER LENDERS

The scope of regulation and legislation applicable to peer-to-peer (P2P) lenders will depend on the specific nature of the operations; however, P2P lending platforms will typically fund loans or portion of loans and operators of such a platform and will need to be aware of, among other things, Canadian securities law requirements (including prospectus and registration requirements as well as available exemptions) and applicable money laundering, criminal activity and terrorist financing legislation such as the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA).

Regulation of payment services

See **Electronic payment platforms** above.

Application of data protection and consumer laws

In Canada, the federal Personal Information Protection and Electronic Documents Act (PIPEDA) governs the way private sector organizations may collect, use and disclose personal information in the course of commercial activity. Where provincial privacy legislation governing the private sector's collection, use and disclosure of personal information has been deemed as 'substantially similar' to PIPEDA, the provincial legislation will apply instead. Alberta, British Columbia and Quebec each have provincial legislation that supersedes PIPEDA in regulating personal information collection, use and disclosure in the private sector.

Canada's federal Bank Act also contains provisions regulating the use and disclosure pf personal financial information by FRFIs.

Money laundering regulations

The PCMLTFA gives the Financial Transactions and Reports Analyst Centre of Canada (FINTRAC) responsibility for supervising anti-money laundering controls of businesses in Canada that engage in foreign exchange dealing, remittance or transmission of funds, securities dealing, portfolio management and investment advice.

Pursuant to PCMLTFA, businesses are required to verify their clients' identities, maintain certain records, and report suspicious transactions to FINTRAC.

On July 10, 2019, Canada's Department of Finance published amendments to the regulations made under the PCMLTFA which are set to come into force on June 1, 2020 and 2021. Among these regulations is an expanded definition of money services businesses to include domestic and foreign business that are dealing in virtual currency (see What is a Cryptocurrency? above). Accordingly, person and entities dealing in virtual currencies will soon be subject to similar obligations as other reporting entities.

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake or some other form of interest such as a convertible note. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital (VC) providers, which permits the founder to pursue the growth of the business as the founder and its advisors envision.

CROWDFUNDING

The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform. Crowdfunding activities in Canada are typically subject to applicable securities laws (including in respect of the platform as well as the equity security being offered).

There are two three main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares or other securities being issued in exchange for investment in the company.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access; however, crowdfunding has not had significant success and adoption as a means to finance startup businesses in Canada, with most FinTech startups pursuing the other methods of financing referred to below.

ACCELERATORS

There are various early-stage business incubators and accelerators in the Canadian market which offer support, facilities and funding for startups, often in return for an equity stake.

Venture capital and debt

VC funding is a type of equity investment usually targeted at early stage FinTech companies. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a funding division of a corporation. The benefit of having a CVC as an investor for a FinTech startup is that, among other things, the investor is able to share its sector knowledge and expertise with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a fixed term loan (or series of loans), which is secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company at a discounted price upon certain events or otherwise. There are also other financing alternatives that may be put in place with venture investors or lenders such as a simple agreement for future equity. The merits of these structures should be discussed with your legal and financial advisors.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Typically, once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Canada has both debt and equity capital markets which are accessible to businesses of varying sizes. For example, a FinTech company may elect to become a reporting issuer in one or more of the provinces and territories of Canada through an initial public offering of its securities (IPO). In Canada, an IPO involves the issuance and sale of securities of the company and a concurrent listing on a stock exchange. An IPO may be completed in different ways, including by way of a reverse take-over of an existing public company.

CONVERTIBLE BONDS/LOAN NOTES

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances (for example, upon the completion of an IPO or the raise of a certain amount of investment).

Incentives and reliefs

The Canadian provinces and territories as well as the federal government, offer various tax credits, tax benefits and other incentives. These include the Scientific Research and Experimental Development Tax Incentive Program (SRED) or research and development (R&D) tax credit, to provide qualified Canadian companies with funds to undertake capital expenditures to reduce costs and generate marketing dollars to promote commercialization efforts. Depending on where in Canada the FinTech business is established and/or operates, certain other credits and incentives may be available, such as e-commerce credits and technology and innovation credits. In addition to various incentives and reliefs that may be available, the Federal Government also supports certain venture funds with FinTech companies as desired investments and there are government funds designed to do the same.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are as follows.

Novation

A novation is a tripartite arrangement among the original parties to a contract and a transferee seeking to replace the transferor to the contract. It is a full legal transfer of the transferor's rights, benefits and obligations to the transferee. All parties to the original contract

need to consent to the new contract and the non-transferring party must accept the new contract in full satisfaction of, and as substation for, the old contract.

Assignment

An assignment is a transfer of rights and benefits of the transferor only, not its obligations under the contract. Subject to any contractual restrictions, assignments generally can be done without the consent of the non-assigning party to the contract. The burden under the original contract remains with the assignor and, as such, the assignor can be held liable if the assignee fails to perform the obligations under the contract. An assignment does not replace the original contract and does not create a new contract.

Generally, loan transfers will be documented using the bank's standard form documentation. The form and content of the transfer documentation will depend on the nature of the loan assets being sold.

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What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the seller's legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its terms; and
- **consent and notification** – whether a transfer requires the consent or notification of any other parties.

Last modified 2 Jan 2020

Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of energy and infrastructure assets in Canada varies according to the asset class.

The main asset classes include:

- energy, including both electricity and gas distribution, as well as oil and gas production;
- public transit;
- trade and transportation, including roads and bridges;
- telecommunications;
- municipal, including water and wastewater and waste disposal; and
- social infrastructure, including education, health and justice/prisons, housing.

Key sectors are considered below.

Energy

The ownership of gas and electricity supply utilities varies significantly from province to province and in some cases from asset class to asset class. Long distance pipeline and gas transmission infrastructure crosses provincial and national boundaries and is privately owned. Gas distribution networks within provinces are generally also privately owned, with a small group of established utilities dominating the market.

In the electricity sector, each province has its own transmission grid, with a somewhat modest level of 'east-west' intertie capacity between provinces and, in some provinces, with significant 'north-south' intertie capacity with US systems. Provincial transmission systems are either owned by private entities and/or by publicly-controlled Crown corporations. For example, Alberta's transmission system is owned by several large private utilities. The majority of Ontario's transmission system is owned by Hydro One, which was historically a 100% provincially owned Crown corporation, but now privatized (Hydro One had an initial public offering in 2015. The Province of Ontario directly owns 47.4% of the shares of Hydro One. The remaining 52.6% of its shares now trade publicly (although provincially-owned Ontario Power Generation holds about 1.5%). British Columbia's transmission system is owned by BC Hydro, also a provincially owned Crown corporation.

Local distribution systems may also be privately or publicly-owned. Alberta is characterized by private and municipal ownership, whereas Ontario's distributions systems have historically been operated by municipally owned utilities or, in rural and some urban areas, by Hydro One. Generation assets may also be privately or publicly owned. Ontario offers an illustrative mix, in that some large hydro and nuclear baseload facilities are owned by a Crown corporation (Ontario Power Generation), some nuclear facilities are privately owned (e.g., Bruce Power), and most gas-fired, wind and solar facilities are privately owned. British Columbia's largest generating facilities are owned by BC Hydro, while several smaller cogeneration facilities as well as wind and hydroelectric facilities are owned by private investors. Alberta's generation fleet is owned by private investors and by municipally-owned utilities.

Oil and gas infrastructure in Canada, including both exploration and production of petroleum and gas and pipeline infrastructure, is almost entirely privately owned. While at one time the Canadian federal government and some provincial governments maintained some ownership interest in the oil and gas industry, those interests have been entirely sold off. There are many hundreds of companies in the exploration and production space, ranging in size from vertically integrated global majors to very small venture firms. There are several dozen companies active in the transmission and distribution pipeline space.

There is one significant exception to private ownership in the oil and gas space. The Trans Mountain pipeline, which carries a variety of crude oil and refined products from Edmonton to Vancouver, was purchased by the Canadian federal government in 2018 in the midst of an expansion project stalled in court challenges and regulatory delays. It is widely expected that the Trans Mountain pipeline will be privatized after the completion of the expansion project, expected in mid-2022.

The National Energy Board regulates aspects of the energy system that cross inter-provincial and international borders. For example, the NEB regulates the construction and operation of interprovincial and international oil and gas pipelines (including tolls and access), international power lines and designated interprovincial power lines, the export of oil, natural gas and electricity, and the import of electricity. Provincial regulators are responsible for similar matters which take place entirely within a province. For example, in Ontario, the Ontario Energy Board regulates electricity and gas rates, licenses generators and distributors, and grants leave to construct certain gas and electricity distribution lines, while the Independent Electricity System Operator manages the transmission grid and runs the wholesale electricity market. In Alberta, the Alberta Energy Regulator regulates oil and gas matters and the Alberta Utilities Commission regulates utility matters such as electricity transmission and distribution.

Telecoms infrastructure

Telecommunication infrastructure, including telecommunication and broadcast systems, is primary privately owned in Canada. Three incumbent carriers (Bell, TELUS and Rogers) own the majority of the landline, wireless, and internet networks, with some smaller and regional carriers attempting to gain market share. There are a number of privately owned Canadian broadcasters, as well as the publicly owned Canadian Broadcasting Corporation (CBC).

The telecom sector is extensively regulated, including by the Canadian Radio-television and Telecommunications Commission (CRTC) and by Industry Canada (which, for example, manages wireless spectrum).

Transport infrastructure

ROAD INFRASTRUCTURE

The majority of Canadian highways are the responsibility of provincial or territorial jurisdictions and the provincial or territorial governments are primarily responsible for the planning, design, construction, operation, maintenance, rehabilitation and financing of the road network. There are limited exceptions to this general rule. Highways which run through National Parks are the responsibility of the federal government and a small percentage of highways fall under municipal jurisdiction.

In comparison to other countries, Canada's use of tolling on its highway infrastructure is limited. The main exception to this is international bridge crossings between Canada and the US, which are tolled (although the current federal government has commited to removing tolls from the replacement Champlain Bridge International Crossing under construction in Montreal, Quebec). One example of a tolled highway is Highway 407 to the north of Toronto, Ontario, which is owned and operated by a private consortium.

While the responsibility for highway infrastructure falls to the provincial and territorial governments, the federal government does invest significantly in highway and road infrastructure through funds administered by Transport Canada and Infrastructure Canada. Federal government also owns and maintains a number of strategic bridges in Quebec and manages the Canadian portion of several international bridges.

In recent years, significant spending has been incurred in relation to road transportation infrastructure and this has encouraged the development of alternative means of procurement for such infrastructure, including public-private-partnerships dependent on private financing.

RAIL TRANSPORT

Canada has a large rail network including two major publicly-traded Class I freight railway companies, Canadian National Railway Company and Canadian Pacific Railway Company, as well as shortline railways that connect to them; and deliver traffic to and from them. Passenger rail services are provided nationwide by VIA Rail, a federal Crown Corporation. Commuter services are also provided at various locations by urban transit authorities owned or controlled by different levels of government.

Within urban municipalities, subway and light rail systems have been a particular focus of investment. LRT systems exist in a number of Canadian cities, including Toronto, Ottawa, Calgary and Edmonton.

Rail transportation is regulated at the federal level for both national and inter-provincial railways. Short line railways operating intra-provincial rail systems are generally subject to provincial regulation, although responsibility and oversight for parts of their operations are sometimes ceded by a province to federal authorities.

For subway and light rail systems that operate within municipal boundaries, the municipalities have responsibility and a number of the recent subway and LRT projects have been procured by municipal authorities albeit with significant amounts of provincial and federal funding.

Social infrastructure

Healthcare infrastructure in Canada is primarily the responsibility of the relevant province and healthcare expenditure is a significant portion of the budgets of each of the provinces across Canada. Hospitals are almost entirely public with relatively limited availability of private healthcare facilities.

Similarly, provinces are responsible for the organization, delivery and assessment of education at the elementary and secondary levels and for post-secondary education. A number of jurisdictions have procured 'bundled' school projects through alternative financing processes and public-private-partnerships. Most notably, Alberta has procured three sets of bundled schools through PPPs and Saskatchewan has also implemented a bundled school project.

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Are there special rules for investing in energy and infrastructure?

Generally

There is no specific regime governing or restricting investment generally in infrastructure projects in Canada. Depending on the nature of an investment and the parties involved, a particular investment may be subject to rules of general application. For example, significant mergers may be reviewable under the federal Competition Act and acquisitions of control by foreign entities may be subject to notification and/or substantive review under the federal Investment Canada Act, which has jurisdiction to determine whether an investment by a foreign entity is of 'net benefit to Canada'. There is closer scrutiny where the investment by a foreign entity may raise issues of national security or where the investing entity is controlled by a foreign government (a 'state-owned enterprise'). Projects may also be subject to a variety of types of approval ranging from environmental approvals or municipal permitting requirements.

Energy

There are no special rules for investing in oil and gas. As noted above, certain large investments by foreign entities may be reviewed under the Investment Canada Act or Competition Act, and investments by state-owned enterprises may attract additional scrutiny. In particular, the purchase of oil sands projects by state owned enterprises will generally be forbidden.

The electricity markets in Canada are heavily regulated. In some cases, these regulations are directly relevant to investment in electricity infrastructure. As one example, in Ontario, severe tax consequences can arise if a municipally owned distribution sells distribution assets to a private-sector entity or undergoes significant investment by a private-sector partner. These consequences have been a significant barrier to private-sector investment in the distribution sector but have recently been the subject of partial, time-limited exemptions (currently set to expire January 1, 2023) that are intended to spur consolidation in the sector.

As discussed further below, the manner in which electricity infrastructure (generation in particular) varies significantly across the country, with jurisdictions like Alberta traditionally preferring deregulated approaches based on merchant market pricing while jurisdictions like Ontario have historically run highly structured procurements that resulted in long-term power purchase agreements at fixed prices. Investors wishing to make greenfield investments in a province therefore need to acquire an intimate understanding of that province's procurement regime. Ontario's evolving market is an illustrative case: after running a feed-in tariff (FIT) program for many years that spurred significant private-sector investment in new renewable generation, the province has recently brought that FIT program to an end, is exploring ways to move to more market-based procurements of capacity and energy, and is even exploring options for reducing the cost of legacy power purchase agreements. While Alberta has traditionally pursued a deregulated approach to generation (requiring investors to pursue their own long-term offtake contracts), it has recently started to encourage the development of renewable energy projects by providing long term price supports for selected renewable electricity projects. Investors wishing to invest in existing projects must also review the applicable regime carefully, including for restrictions on changes of control and requirements to retain levels of community and aboriginal equity participation.

Telecoms infrastructure

The federal Telecommunications Act places Canadian ownership and control requirements on telecommunications common carriers. As a starting point, telecommunications common carriers must be at least 80% beneficially owned by Canadians with at least 80% of the board comprising Canadian individuals. In 2014, in response to calls to increase competition in the marketplace, the Canadian government introduced an exception to these requirements for carriers having less than 10% market share. Given overwhelming concentration of market share with the large incumbents, this exemption only applies to a very small number of carriers.

Canadian broadcasters are subject to similar Canadian ownership and control requirements. The voting shares and votes of the broadcaster must be 80% owned by Canadians, Canadians must comprise at least 80% of the board of directors, the CEO must be Canadian, and the broadcaster cannot be controlled in fact by non-Canadians. Some companies that have integrated telecommunications and broadcasting businesses may be subject to the requirements applicable to broadcasters even if they qualify for the exemption available to smaller telecommunications carriers.

As it currently stands, Canadian ownership and control requirements do not apply to over-the-top video (OTT) broadcasters that distribute programming only through the Internet or on mobile devices in accordance with the CRTC's Exemption order for digital media broadcasting undertakings. Given the growth of this type of business, the applicable regulations have the potential to evolve in the coming years.

Transport infrastructure

For rail infrastructure, while there are rules requiring licensing and other regulatory approvals under federal legislation and regulations, in systems which are operated by municipalities or public agencies, private entities can participate through the provision of infrastructure, including rail systems and rolling stock. A wide range of private entities participate in the market for the design, construction, operation, maintenance and rehabilitation of rail systems and vehicles.

Since 2004, provinces and municipalities have increasingly looked to alternative procurement models, particularly public-private partnerships for the procurement of rail and LRT projects.

Similarly, in road transportation there are no special rules for investing in entities which are involved in the design and construction of highways or in their maintenance and rehabilitation. Again, a number of provinces have utilized public-private partnerships as the procurement model for new highways, key road, and bridge infrastructure.

Social infrastructure

While hospitals are primarily publicly owned, they are designed, constructed and maintained by private entities and in numerous provinces, public hospitals have been the subject of public-private-partnerships and alternative forms of procurement, notably in British Columbia and Ontario.

Similarly to jurisdictions outside Canada, on infrastructure projects, whether transportation or social, which are procured by the public sector, there is regularly a 'change in ownership' restriction which applies in relation to the private entity or consortium carrying out the construction of a publicly procured project. This restriction on change in ownership is often, but not always, removed within a year of two of successful operation of the public facility to enable recycling of capital by entities involved in infrastructure development. This also promotes the development of an active secondary market in infrastructure assets.

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What is the applicable procurement process?

Investing in infrastructure

While there is no legislative regime specifically covering the public procurement of infrastructure assets, a body of law has developed relating to the procurement of such projects by public sector organizations. The principles that underpin this jurisprudence are primarily directed at fairness and transparency on the part of the public authority in relation to bidding entities. The development of a two-stage request for qualifications/request for proposals process has emerged as a very common means of conducting such procurement. Following initial qualification, usually based on experience of similar or related projects, the public authority selects a relatively small number of bidders to proceed to the request for proposals stage. Under the relevant Canadian jurisprudence, the documentation setting out the rules of engagement for the procurement establish an offer, which is accepted and converted into a contract (Contract A) when a proponent submits a compliant bid. This is distinguished from the contract for the development of the facility or asset (Contract B), which is ultimately entered into between the authority and the proponent when it is selected as the winning bidder.

Investing in energy

The construction of new oil and gas infrastructure, such as pipelines and distribution systems, being privately owned, is not subject to public tendering or procurement processes.

There is an element of public procurement to the awarding of leases for oil and gas exploration. Most oil- and gas-producing lands in Canada are owned by the provinces, which conduct periodic sales of the right to explore for and produce petroleum from those lands. The sales are generally conducted via an open, public auction. A party wishing to purchase lands for oil and gas exploration may either participate in one of these auctions (which are generally for the sale of unexplored and unproven lands) or may purchase existing, proven oil and gas leases from existing producers.

The methods by which new electricity infrastructure is procured vary from province to province and also evolve with time.

Many transmission projects are undertaken by the incumbent utilities without a public procurement process. For example, the reinforcement of the Bruce-to-Milton line in Ontario was undertaken by Hydro One has part of its system planning. While an aboriginal group received an equity stake in the project, the opportunity was not generally open to outside equity investors. Some large transmission projects are initiated through a public procurement process open to all prospective developers, not just the regional

incumbent. For example, the Alberta Electricity System Operator ran a competitive develop-design-build-finance-own-operate-maintain process for the construction of a 500km, 500kV line serving Fort McMurray.

Distribution projects tend to be undertaken by existing distribution utilities. While procurement process may be run to obtain design, construction and other services, the projects as a whole are usually managed by the utilities.

Generation projects may be, but are not universally, publicly procured. Alberta has historically taken a 'hands off' approach to generation, allowing private sector developers to undertake new projects in response to wholesale pricing and other negotiated offtake agreements. However, it has recently prioritized the development of renewables - as described above, the Alberta government has provided price supports for the generation of renewable electricity from projects selected in a competitive bidding process conducted over several rounds in 2017-2019. Ontario's approach continues to evolve. The Feed-in Tariff (FIT) program introduced in 2009 offered 20-year power purchase agreements at guaranteed rates to developers of wind, solar, hydro and biomass/gas projects. Development of grid-connected projects boomed, but that boom is now over as the Independent Electricity System Operator (at the behest of the Province of Ontario) cancelled the FIT program, terminated hundreds of FIT version 5 contracts that were pre-construction, announced a zero-tolerance policy for delays projects that are under construction, and commenced a review of the contracts of existing projects to identify cost savings opportunities. The IESO has recently shifted to a transitional capacity auction market to procure generation, but the IESO's long-term strategy for generation procurement continues to evolve.

Financing infrastructure and energy

Financing for infrastructure and energy projects is not generally the subject of a separate public procurement process. The manner in which a particular project has been procured will, however, have a significant impact on financing terms.

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What are the most common forms of funding / investing in energy and infrastructure?

Funding

Common forms of funding in energy and infrastructure include:

- loans made on a corporate-finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium to long-term bases – such loans may later be syndicated to other funders;
- bond finance;
- hybrid financing, particularly on long term projects where the initial design and construction activities or a portion thereof are paid for through one or more progress or milestone payments. In these cases, the deisgn and construction activities are financed by short-term construction facilities from commercial banks, whereas the long term debt is provided by way of bond financing, either underwritten or privately placed;
- mezzanine debt (in some sectors); and
- refinancing of the debt in operational projects.

Infrastructure financing

The financing of infrastructure will largely depend on the nature of the contract which is being let for the development of the relevant facility. Standard construction financing is available from commercial banks in the Canadian domestic market for design-build contracts for the construction of facilities. These are predominantly short-term facilities that are paid off through milestone or progress payments as the construction develops or through a substantial completion payment towards the end of construction.

If the procurement of the relevant facility involves operation, maintenance or rehabilitation of the facility throughout its useful life, then long-term financing is regularly utilized. Until 2008, European lenders regularly lent long-term debt into the Canadian market. Canadian commercial banks are reluctant to provide long-term tenors and so Canadian commercial bank debt is not available for long-term financing. However, with the shorter tenors being offered by European lenders after 2008, the Canadian capital markets have largely replaced long-term commercial bank debt. There are two primary forms of long-term financing used in infrastructure development. The

first is the private placement of long-term debt, usually through bond or note facilities to long-term institutional investors such as life insurance companies. These debt instruments may be rated or unrated. The second predominant mode of financing for long-term debt is the broadly marketed underwritten bond, which is usually a rated product. Each of the main six Canadian banking institutions will provide underwriting for such a capital markets issuance. Bonds are usually sold down to long-term bondholders with life insurance companies again being major investors in this class of debt.

Investing

Common forms of investing in energy and other infrastructure include:

- 'equity' investment in special purpose vehicles or entities that may have a portfolio of interests, including share capital, limited partnership interests, and/or subordinated shareholder/unitholder loans; and
- secondary market investment in operational projects (acquisition of 'equity').

Unlike other markets (in particular the US), tax equity structures are not typically employed for electricity projects as Canada does not have the same focus on tax incentives as a means of promoting these projects. Similarly, tax-exempt banks are not a feature of debt financing in the Canadian market.

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Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

There is no single body that investigates regulatory non-compliance. Each regulatory statute generally establishes an enforcement body charged with enforcing the statute.

When the applicable regulatory authority considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch an investigation. This may result in regulatory sanctions or penalties.

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What regulatory penalties may apply?

The scope of the applicable regulatory authority's powers are set out in the governing legislation. Generally, when a breach has taken place the applicable regulatory authority may impose a financial penalty or censure, or withdraw regulated status against the firm or regulated individuals.

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What criminal penalties may apply?

Depending on the nature of the breach, the applicable regulatory authority may disclose cases of non-compliance to law enforcement, including, but not limited to, cases relating to:

- insider dealing;
- breaches of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Canada); and
- fraud.

Criminal penalties may include fines and/or imprisonment.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

No stamp, registration, transfer or other similar taxes are payable on the advance, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

No stamp, registration, transfer or other similar taxes are payable on the taking, transfer or assignment of a mortgage, debenture or other security. There may be nominal registration fees required to perfect a security interest.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (eg a bond)?

No stamp, registration, transfer or other similar taxes are payable on the issue, transfer or assignment of a debt security.

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Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

Generally, secured lenders and secured debt security holders take priority over the Canada Revenue Agency on enforcement of security, provided that the Canada Revenue Agency has not previously taken steps to register itself as a secured creditor. However, the Canada Revenue Agency has a 'super priority' right over secured creditors (other than holders of a mortgage over real property) with respect to taxes collected by the debtor on behalf of the Canada Revenue Agency (including employee source deductions, non-resident withholding tax and goods and services tax (GST)). This 'super priority' does not extend to GST if the tax debtor is in a proceeding under the Bankruptcy and Insolvency Act or the Companies' Creditors Arrangement Act.

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Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

Canada does not impose withholding tax on interest payments under a loan from a Canadian resident lender unless the loan is part of a back-to-back loan arrangement. Generally, a back-to-back loan arrangement is one in which a third party (whether resident in Canada or not resident in Canada) is interposed between a Canadian borrower and a lender not resident in Canada in an attempt to avoid the application of withholding tax that would otherwise apply.

Canada does not impose withholding tax on interest payments under a loan from an arm's length lender not resident in Canada unless either:

- the interest is 'participating debt interest'; or
- the loan is part of a back-to-back loan arrangement (as described above).

'Participating debt interest' is defined as interest that is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of a corporation.

Canadian withholding tax generally applies to interest payments to a non-arm's length lender not resident in Canada.

If so:
What is the rate of withholding?

If applicable, the current rate of Canadian withholding tax on interest is 25%.

What are the key exemptions?

Where Canadian withholding tax does apply to interest payments, the primary exemption is under a double tax treaty (such treaty may only provide for partial exemption). For instance, under the Canada-United States tax treaty, interest paid to a non-arm's length US resident lender is exempt from Canadian withholding tax. However, under the Canada-United Kingdom tax treaty, the withholding tax rate is 10% on interest paid to a non-arm's length UK resident lender.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes, the analysis described above is applicable to both interest payments under a loan or other form of debt security.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding taxes (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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