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COMPLIANCE WITH PROVINCIAL LAWS — WHAT COMPLIANCE OFFICERS NEED TO KNOW

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While ignorance may be bliss in some cases, it is generally not regarded as an acceptable state of affairs by regulators when it comes to the question of how financial institutions ensure they are complying with all applicable laws. Guidelines issued by the Office of the Superintendent of Financial Institutions (“OSFI”) and Québec’s *Autorité des Marchés Financiers* (“AMF”) explicitly state that a financial institution should (1) be aware of what laws, regulations and supervisory guidelines apply to it, (2) ensure that compliance with these laws, regulations and guidelines are incorporated into regular compliance reviews, and (3) ensure that controls and procedures are in place to manage the risk of non-compliance.

Compliance with, and even full awareness of, the entire universe of laws, regulations and supervisory guidelines that apply to Federally Regulated Financial Institutions (“FRFIs”) is difficult to achieve. There is a great number of statutes, regulations and guidelines at both the federal and provincial level, and many institutions—particularly banks—are uncertain about how these statutes, regulations, and guidelines apply given the interplay between federal and provincial jurisdiction.

This paper is intended to provide an orientation regarding the application of provincial laws to FRFIs. This paper is organized into three sections:

1. An overview of the various types of provincial law that apply or may apply to FRFIs.
2. A summary of the key constitutional law principles that are used by the courts to determine whether provincial laws, or provisions therein, can apply to entities operating in the federal regulatory sphere.
3. A discussion of the Supreme Court of Canada’s decisions in *Bank of Montreal v. Marcotte*, with a particular focus on the implications for compliance.

1. The Application of Provincial Law to Banks

The first hurdle that must be surmounted by FRFIs seeking to meet OSFI’s and the AMF’s broad expectations concerning compliance is to identify which laws may impose applicable obligations. While all FRFIs presumably understand that they are subject to certain federal laws, there is more

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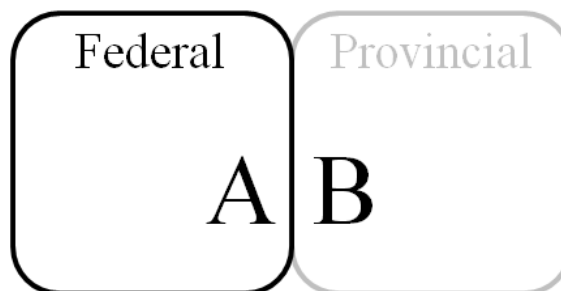
uncertainty regarding the application of provincial laws. This issue has received significant attention recently as a result of the Supreme Court of Canada’s decisions in *Bank of Montreal v. Marcotte*.

While the application of some provincial law to FRFIs is obvious, it bears mentioning. Provincial laws of general application, such as those governing real property, contract law, or access to civil remedies, apply to FRFIs in the provinces in which they operate. In this respect, FRFIs operate within much the same legal landscape as any other private actor when they purchase or lease real property, enter into contracts, and pursue or defend claims in provincial courts.

The application of other provincial laws may depend on the factual circumstances of an FRFI’s activities, such as the application of provincial labour and employment standards or human rights legislation. The Federal Court of Appeal’s held in *Canada (Human Rights Commission) v. Sun Life Assurance Co. of Canada*—later affirmed by the Supreme Court of Canada—that all bank employees are integral to the performance of their banking activities. A bank’s employment of tellers, clerks, and even a stationary engineer have been held to be governed by federal labour laws. However, in making these determinations, courts and labour tribunals rely on the connection between the work these employees perform and the federal undertaking of banking, not the fact that their employer is a bank. In one instance, the Ontario Labour Relations Board determined in *Re C.J.A., Loc. 785 and Toronto-Dominion Bank* that the fact alone that an employer is a bank is insufficient to exclude provincial labour relations legislation where work performed is not vital, essential or integral to banking operations, such as building a new bank branch. The Board’s decision was appealed all the way to the Supreme Court of Canada, which ultimately refused to hear the appeal.

Factual analyses of this nature require the determination of whether a particular activity is governed by either a federal or a provincial regulatory scheme to the exclusion of the other scheme. The exclusive nature of this type of determination is depicted below in Graphic 1. For example, in the employment context, the rights and obligations of a bank *vis-à-vis* its employees (activity “A”) will generally be regulated by the federal *Canada Labour Code*. However, as suggested by the holding in *Re C.J.A., Loc. 785*, there is a risk that, in certain limited circumstances, an employee’s activities could be found to be regulated by the *Ontario Labour Relations Act* (activity “B”).

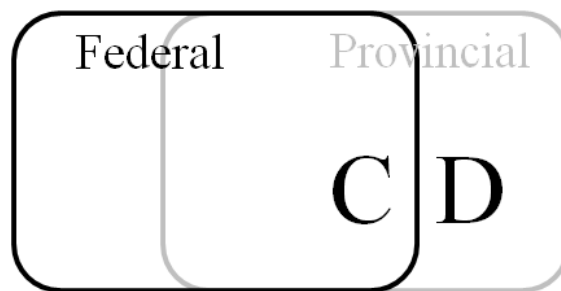
Graphic 1



Where FRFIs may encounter the most difficulty in identifying the degree to which they are subject to certain provincial laws is where the subject matter of the law in question is governed at both the provincial and federal levels of government. This was the issue in *Marcotte*.

As will be elaborated on in Part 3, in *Marcotte* the Supreme Court of Canada held that the Québec *Consumer Protection Act* (“QCPA”) may apply in some cases insofar as its provisions supplement the federal consumer protection regime found in the *Bank Act* and regulations made thereunder. Considering the possibility that the analysis in *Marcotte* could be successfully applied to other overlapping regulatory schemes, compliance officers will not be able to halt their analysis of whether a particular activity is compliant with all applicable law upon determination that they are compliant with federal law. They should also canvas whether provincial regulation in that area supplements the federal scheme, in which case further legal analysis of the supplementary provisions will be required. In the depiction below labelled Graphic 2, “C” represents activities that must comply with federal law, whereas “D” represents activities that are beyond the contemplation of federal law but that, nonetheless, may be subject to provincial law.

Graphic 2



2. Key Constitutional Law Principles

The power to make laws in Canada is divided between the federal Parliament and the provincial legislatures. The *Constitution Act, 1867* (the “Constitution”) sets out the subject matters that each level of government is permitted to govern (known as “heads of power”). The heads of power that are generally exclusive to Parliament include, among other things, banking, the incorporation of banks, and savings banks. The heads of power that are generally exclusive to the provincial legislatures include, among other things, property and civil rights in the province.

In enforcing the division of powers of the federal and provincial levels of government, courts apply a number of guiding constitutional principles, which are discussed below. The guiding principles are not exclusive and are to be read together to form a broader interpretative framework.

Pith and Substance

In order to determine the constitutional validity of legislation or legislative provisions from a division of powers perspective, the court must analyze the “pith and substance” of the impugned legislation. This analysis looks at both the purpose and effects of the law in order to identify its “main thrust” or “true nature”. To assess the law’s purpose, courts may consider both intrinsic evidence, such as the legislation’s preamble or purpose clauses, and extrinsic evidence, such as Hansard. In analyzing the law’s effects, courts will examine, among other things, the legal effect of the law’s text as well as practical consequences arising from its application. Once the law’s “main thrust” has been determined, the court must then determine whether it falls under the head of power of the enacting level of government. If it does, the courts will declare the law to be *intra*

vires, or valid. If, however, the law relates to a matter that is outside the jurisdiction of the legislating body, it will be declared *ultra vires*, or invalid.

The pith and substance doctrine recognizes that, in practice, it is nearly impossible to enact legislation that will not incidentally affect matters within the jurisdiction of another level of government. For example, it would be impossible for Parliament to make effective laws in relation to copyright without affecting property and civil rights, which are under the provincial head of power. In these instances, courts continue to focus on the dominant features of the legislation and set aside any such “incidental effects” that may exist and that are secondary to the law’s main thrust. Thus, if the dominant feature of the proposed law is *intra vires*, incidental effects on matters within the jurisdiction of another level of government will not render it unconstitutional.

In some instances, the effect of an enacting body’s law on the other level of government’s jurisdiction goes beyond “incidental effect” and instead constitutes a substantial intrusion. In such cases, the ancillary powers doctrine may be available to save a law from invalidation. Where a level of government enacts legislation containing specific provisions that are beyond the scope of its enumerated powers and would therefore be unconstitutional, the ancillary powers doctrine allows courts to nevertheless uphold such provisions if they form an important part of a broader legislative scheme that is within the competence of the enacting body. Additionally, some matters are by their very nature impossible to categorize under a single head of power: they may have both provincial and federal aspects. Laws that present a “double aspect” in this way are held to be competent to either (or both) levels of government.

Paramountcy

Although overlap is common and generally unproblematic, in some circumstances, the overlapping laws will conflict with each other. Where a conflict exists between a valid federal law and a valid provincial law, the doctrine of paramountcy holds that the federal law prevails and the provincial law is inoperative to the extent of the conflict.

Conflict can be established in two circumstances: (1) where it is impossible to comply with both the federal and provincial law; or (2) where compliance with the provincial law would frustrate the purpose of the federal law. Importantly, the Supreme Court of Canada has held that when determining whether such a conflict exists, courts must never lose sight of the fundamental rule of constitutional interpretation that when a federal statute can be properly interpreted so as not to interfere with a provincial statute, such an interpretation is to be applied in preference to another interpretation that would bring about a conflict between the two statutes. As, the Supreme Court of Canada recently held in *Marcotte* that “care must be taken not to give too broad a scope to paramountcy on the basis of frustration of federal purpose.”

Interjurisdictional Immunity

As we have seen under the pith and substance doctrine, the incidental effects of a law are constitutionally irrelevant. Legislation may be upheld even if it touches on matters that, viewed in isolation, might be outside the legislative jurisdiction of the enacting legislature. In certain circumstances, however, it may be unconstitutional to apply an otherwise valid law to a particular level of government. The doctrine of interjurisdictional immunity was developed by the courts to address such cases.

Interjurisdictional immunity operates to prevent laws enacted by one level of government from impermissibly trenching on the “unassailable core” of a power reserved for the other level of government. The doctrine allows certain entities to be immune from the application of otherwise valid legislation. In other words, although the law remains valid, it is “read down” by the court such that a particular person or entity is exempt from the law’s application. A law will be inapplicable to the extent that its application would “impair” the core of the non-enacting government’s head of power. Impairment occurs where the head of power (federal or provincial) is seriously or significantly trammled. Although the Supreme Court of Canada has confirmed that the doctrine of interjurisdictional immunity continues to exist, it has cautioned against excessive reliance on it.

3. *Bank of Montreal v. Marcotte*

In September 2014, the Supreme Court of Canada released its decisions in *Marcotte*, which dealt with the question of which level of government has constitutional authority over consumer protection issues involving banks. In these decisions, the Supreme Court of Canada held, for the first time, that provincial consumer protection legislation can apply to a bank’s consumer contracts even if those provincial provisions overlap with the federal legislative scheme applicable to the same contracts. Prior to this decision, it had generally been thought that provincial consumer protection laws did not apply to banks where there was federal legislation addressing the same matters. The class actions that precipitated the *Marcotte* decisions arose out of a very narrow issue concerning the requirements under the QCPA for the disclosure of foreign exchange conversion charges by credit card issuers. All but one of the defendant credit card issuers were banks, thereby giving rise to the constitutional law issue of whether provincial law could apply to the credit-granting powers of banks.

First, the banks argued that the doctrine of “interjurisdictional immunity” should render the QCPA inapplicable to their credit card activities. In response, the Court relied on its prior decision in *Canadian Western Bank v. Alberta* and held that the doctrine of interjurisdictional immunity must be applied “with restraint” and “should in general be reserved for situations already covered by precedent”—for which the Court noted that there is none—particularly in the current “era of cooperative, flexible federalism.” In applying these principles, the Court found that the impugned provisions “do not prevent banks from lending money or converting currency, but only require that conversion fees be disclosed to consumers” and therefore did not impair “the manner in which Parliament’s legislative jurisdiction over bank lending can be exercised.”

Second, the banks relied upon the doctrine of federal “paramountcy,” and argued that the impugned provisions frustrate the purpose of the federal banking scheme, which, according to the banks, has the dual purpose of (i) providing for exclusive federal banking standards that apply across Canada, and (ii) ensuring that bank contracts are not nullified even if a bank breaches its disclosure obligations. On the first point, the Court held that the impugned sections do not provide for such standards, but rather are akin to a rule of contract that applies to all contracts governed by Québec law. For that reason, they do not frustrate the federal banking scheme by providing “standards applicable to banking products and banking services offered by banks, but rather articulate a commercial norm in Quebec.” In short, the Court found that the QCPA requirements are “contract law,” not “banking law,” thereby embedding the provisions within provincial jurisdiction.

On the second point, the Court stated that the banks' argument need not be considered since the plaintiffs sought only a reduction in the amount they were obligated to pay to the banks under those contracts – not nullification. As such, paramountcy was not engaged.

Implications of Marcotte for Banks

It is very difficult to assess the future conclusions that will be drawn from the Supreme Court of Canada's decisions in *Marcotte* because they deal with broad principles. Nevertheless, both new and existing banking products have come under scrutiny for their compliance with provincial law that may now be found to apply.

The possible implications of *Marcotte* are amplified by the circumscription of the doctrines of interjurisdictional immunity and paramountcy by the Supreme Court of Canada's prior decision in *Canadian Western Bank*. The Court stated that interjurisdictional immunity should in general be reserved for situations that are already covered by precedent. The Court also stated that judicial restraint dictates that paramountcy can only apply both where very clear statutory language signals Parliament's intention to "occupy the field" with regard to regulating a particular matter and where no operational conflict is present.

While the extent of the analysis that compliance officers should undertake when ensuring the institution for which they are responsible is compliant with provincial law is yet unknown, this analysis should at least consider:

1. the degree to which a provincial regulatory scheme exceeds the scope of an analogous federal regulatory scheme; and
2. the existence of a provincial scheme that regulates a matter not contemplated by Parliament and that was intended to regulate matters generally in that province.

If a provincial law is identified as being potentially applicable after performing the forgoing analysis, the law or provisions therein would need to be considered in light of the constitutional doctrines discussed in Part 2. This is clearly a challenging task. Each law will require legal analysis tailored to its subject matter, purpose, and effects.

Conclusion

Marcotte undoubtedly complicated the role of compliance officers. Given the complexity of the analysis required to determine that two sections of the QCPA apply to banks doing business in Québec, the task of assessing whether every law in 13 provincial and territorial jurisdictions impose compliance obligations on an FRFI may seem overwhelming. To complete the task of understanding the new regulatory realities incumbent upon FRFIs, compliance officers will need to draw upon additional resources and legal expertise, both internal and external to the FRFI.