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COMPLIANCE WITH PROVINCIAL LAWS WHAT COMPLIANCE OFFICERS NEED TO KNOW

By Koker Christensen and Craig Bellefontaine[*]

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 Authorité 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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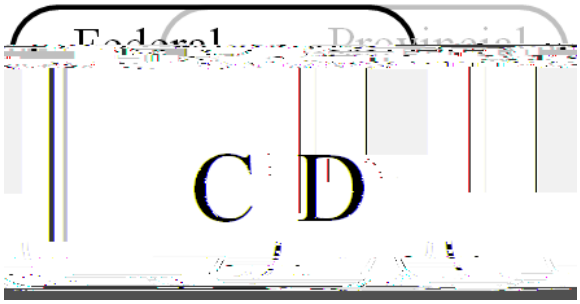
As will be elaborated on in Part 3, in *Marcotte* the Supreme Court of Canada held that the Québec *Consumer Protection Act* ("QCPA") may apply in some cases insofar as its provisions supplement the federal consumer protection regime found in the *Bank Act* and regulations made thereunder. Considering 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

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 trammeled. 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 co-operative, 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.