International Lawyer

Volume 35
Number 2 *International Legal Developments in Review: 2000*

Article 5

2001

International Banking and Finance

Theodore P. Augustinos

Walter Douglas Stuber

Adriana Godel Stuber

Jeffrey P. Greenbaum

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Theodore P. Augustinos, Walter Douglas Stuber,
Adriana Gödel Stuber, Jeffrey P. Greenbaum, Shourya Mandal,
Robert E. Elliott, Robert W. McDowell, Kathleen S.M. Hanly,
and Pandora D. Strasler*

The following article contains the 2000 Report of the Section's International Banking and Finance Committee for this issue. This report addresses (i) U.S. legislative and regulatory developments; (ii) selective Brazilian developments; (iii) selective Canadian developments; (iv) selective European Union developments; and (v) selective Indian developments.

I. United States

After the whirlwind of activity at the end of 1999, which included the enactment of the Gramm-Leach-Bliley Act of 1999 (GLBA),[1] 2000 was a year in which the various effects of the GLBA were reflected in federal and state regulation in several areas. Federal legislation was also adopted with respect to the commercial use of electronic signatures. In addition, there were some regulatory developments of particular interest to foreign banks conducting or seeking to conduct business in the United States.

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*Theodore P. Augustinos (author of section on United States) is a partner in the Hartford office of Edwards & Angell, LLP. Walter Douglas Stuber and Adriana Gödel Stuber (authors of section on Brazil) are respectively founding partner and senior associate of the Brazilian law firm Amaro, Stuber e Advogados Associados in São Paulo, Brazil. Jeffrey P. Greenbaum is a partner in the Rome, Italy office of Lovells, and vice-chair of the International Financial Services Committee. Shourya Mandal (author of section on India) is a partner in Fox & Mandal in Calcutta, India. Robert W. McDowell (co-author of section on Canada), partner, Fasken Martineau DuMoulin LLP, is the director of the Financial Institutions and Services Group in the Toronto, Canada office of the firm. Robert E. Elliott and Kathleen S.M. Hanly (co-authors of section on Canada) are partners in the Toronto office of Fasken Martineau DuMoulin. Pandora D. Strasler, of the Ontario and New York Bars, and admitted as an English solicitor (formerly of Fasken Martineau DuMoulin LLP) is a senior associate in the New York office of Heller Ehrman White & McAuliffe.

1. Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (to be codified in scattered sections of 12 U.S.C.) [hereinafter Gramm-Leach-Bliley Act].

A. Federal Developments Under the GLBA Concerning Activities

1. *Financial Holding Companies—Elections and Ramifications*

Effective March 11, 2000, the Board of Governors of the Federal Reserve System (Federal Reserve Board) adopted an interim rule that established the procedures for becoming a financial holding company (FHC) pursuant to the GLBA.[2] The final rule was issued on December 21, 2000.[3] Essentially, a bank holding company that desires to become an FHC may submit to the Federal Reserve Board its election to become an FHC and a certification that all of the depository institutions controlled by the company are well capitalized and well managed. Pursuant to the GLBA, such an election is ineffective if the Federal Reserve Board finds that any insured depository institution controlled by the bank holding company (other than a recently acquired institution) has less than a satisfactory rating under the Community Reinvestment Act (CRA).[4] The Federal Reserve Board has the authority to limit the commencement or conduct of activities or acquisitions of an FHC if the Board determines that the FHC lacks the financial or managerial strength to engage in new activities, make acquisitions, or retain ownership of companies engaged in financial activities. Otherwise, the election filed by a bank holding company may be simple, short, and self-executing. It is effective on the thirty-first day after receipt by the appropriate Federal Reserve Bank unless the Federal Reserve Board has notified the bank holding company that it does not meet the requirements for an FHC.

Although the mechanism for becoming an FHC is simple and quick, the ramifications of failing to satisfy the capital and management requirements for FHCs after the election are severe. FHCs are required to notify the Federal Reserve Board of any such failure.[5] Once the Federal Reserve Board determines that all the requirements have not been met, either independently or following the required notice by the FHC, the Federal Reserve Board notifies the FHC. The FHC then has forty-five days to execute an agreement with the Federal Reserve Board pursuant to which the FHC will correct the deficiency. The agreement must explain the actions needed to correct each deficiency, provide a time frame within which each action will be taken, and provide any other information required by the Federal Reserve Board. Before the deficiencies are corrected, the Federal Reserve Board may impose any limitations on the FHC or any of its affiliates, and the FHC is barred from engaging in new activities or making acquisitions without prior approval by the Federal Reserve Board.

If the deficiencies are not corrected within 180 days, the FHC may be ordered to divest all of its subsidiary depository institutions. The FHC may comply with such an order by ceasing to engage in all activities that are permissible only for FHC. If an FHC has a subsidiary depository institution that fails to meet the CRA requirements for an FHCs, then the FHC is prohibited from commencing any new activities or making acquisitions,[6]

2. Bank Holding Companies and Change in Bank Control (Regulation Y) Regulations, 12 C.F.R. § 225 (2001). Non-bank companies must first become bank holding companies prior to becoming FHCs, although they can file the FHC election at the time they file their bank holding company application, and provide that it will become effective upon the Federal Reserve Board's approval of the FHC application.

3. *Id.*

4. *Id.* § 225.82.

5. *See id.* § 225.83.

6. This restriction would not prohibit investments as part of previously permitted merchant banking, investment banking, or insurance company investment activities.

other than activities and acquisitions "closely related to banking" pursuant to Section 4(c)(8) of the Bank Holding Company Act of 1956, as amended.[7]

2. *Financial Holding Company Status of Foreign Banks*

On December 21, 2000, the Federal Reserve Board issued regulations pursuant to which foreign banks may obtain FHC status for purposes of the GLBA.[8] Initially, the Federal Reserve Board would have required that notices by foreign banks to become FHCs would become effective only after an affirmative finding by the Federal Reserve Board that the institution's capital and management satisfied the required standards. Although these standards were comparable to those required of U.S. banks owned by FHCs, in the case of U.S. banks, the notice to become an FHC becomes effective on the thirty-first day after filing.

In response to protests, the Federal Reserve Board amended the process for foreign banks to more closely resemble the process for domestic banks. Notices filed by foreign banks will become effective on the thirty-first day after filing in the absence of a finding by the Federal Reserve Board that the election was ineffective or that the agreement by the foreign bank to extend the review was inadequate.[9] Despite the relaxation of the procedural requirements, foreign bankers continued to complain to the Federal Reserve Board that the processing of notices by foreign banks involves the application of discretionary standards by the Federal Reserve Board, as opposed to the processing of domestic bank notices, which does not involve a substantive subjective review.

3. *Interagency Regulations on Bank Insurance Sales Adopted Effective April 1, 2001*

The U.S. federal banking regulatory agencies jointly adopted regulations governing bank insurance sales.[10] These regulations, adopted pursuant to Section 305 of the GLBA for consumer protection, focus on disclosure as the way to protect consumers purchasing insurance sold by or through banks. The rules include oral and written disclosures about the relationship of the bank to the insurance sales activity and the prohibition against potentially coercive activities.[11] In addition, the new regulations, effective April 1, 2001, limited certain disclosures. For example, the federal banking regulators recognized that it is illogical or unnecessary to require disclosure of investment risks in the context of sales of insurance without an investment component, such as property and casualty insurance.

The regulations apply to banks and "covered persons," defined by the regulations to include the bank and any other person selling, soliciting, advertising, or offering insurance products to a consumer at an office of the bank or on behalf of the bank.[12] Activities on behalf of a bank include activities where a person (at any location) sells, solicits, advertises, or offers insurance products and at least one of the following applies: (i) the person represents to the consumer that the sale or offer of insurance is by or on behalf of the bank; (ii) the bank refers a consumer to a seller of insurance and the bank has a contractual arrangement to receive commissions or fees derived from a sale of insurance resulting from the referral; or (iii) documents evidencing the sale or offer of insurance identify or refer to the bank.[13]

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7. 12 C.F.R. § 225.123.
8. *Id.* § 225 (2001).
9. *See id.* § 225.92.
10. *Id.* §§ 14 (2001); 208 (2001); 343 (2001); 536 (2001).
11. *E.g., id.* § 14.20 (2001).
12. *Id.*
13. *Id.*

In addition, the regulations addressed some of the practical considerations related to bank insurance sales, particularly in the context of small institutions. For example, no physical separation of insurance sales from other banking activities, other than deposit taking, is required. Platform sales of insurance products are permitted without the necessity for using different personnel than those engaged with the consumer on a banking transaction, so long as the bank personnel is properly licensed. Of course, the required disclosures must be provided to the consumer to ensure that the customer recognizes the distinction between the bank's products and services and the offered insurance products and the fact that the bank's credit decisions cannot be conditioned on the sale of insurance.[14]

The banking institution assumes responsibility for making the required disclosures if it sponsors and benefits from the sale of insurance. Otherwise, fulfilling the disclosure requirement may be the sole responsibility of the insurance company or agency. Consistent with the E-Sign Act (described below), the regulations provide that required written disclosures may be provided electronically, rather than on paper, if the customer expressly consents to electronic disclosures.[15]

In addition to requiring disclosures, the regulations require written consumer acknowledgement of the required disclosures. In cases where the sales activity occurs by telephone, the person involved in the insurance sales activity must both obtain an oral acknowledgment from the customer that the disclosures were made and document the acknowledgment, and make reasonable efforts to obtain a written acknowledgement from the consumer.

With respect to fees that may be paid by an insurance agent or company to a bank or its personnel who are not licensed to sell insurance, the regulations clarify that the bank may receive a fee for services (such as performing record keeping, payment, or other functions) where the fee is based on the service and not on the sale of insurance products.[16] Similarly, nominal fees for customer referrals may be paid to banks and their deposit-taking personnel who are not licensed to sell insurance. However, these fees must be one-time, nominal fees, fixed in amount for each referral and not dependant on whether the referral results in a sale of insurance products.[17] Furthermore, the regulations prohibit any bank from permitting any person to sell or offer for sale any insurance product in any part of the bank's offices or on its behalf, unless the person complies with all applicable state insurance licensing standards and requirements.[18]

4. *Merchant Banking Guidelines*

On June 22, 2000, the Federal Reserve Board published guidance for merchant banking activities permitted under the GLBA.[19] This guidance expands on the interim rule on merchant banking adopted jointly by the Federal Reserve Board and the Department of the Treasury in March 2000. The interim rule included recordkeeping and reporting requirements, risk management practices, investment holding periods, limitations on involvement in management, and volume limitations on these investments. The GLBA now permits

14. *E.g.*, *id.* § 14.30.
15. *E.g.*, *id.* § 14.40.
16. *E.g.*, *id.* § 14.50.
17. *See id.*
18. *See id.*
19. Guidance on Equity Investment and Merchant Banking Activities of Financial Holding Companies and Other Banking Organizations Supervised by the Federal Reserve, SR 00-9 (June 22, 2000), *available at* http// www.federalreserve.gov/boarddocs/SRLETTERS/2000/SRO009.htm.

FHCs to make equity investments in nonfinancial companies without the historic restrictions imposed on bank holding companies. The guidance also clarifies disclosure requirements with respect to merchant banking activities by FHCs, and the related equity investments.

5. *List of Financial Activities*

The Federal Reserve Board issued its final rule December 21, 2000, which set forth procedures for domestic bank holding companies and foreign banking organizations to qualify as FHCs. The Board also listed the activities determined to be financial in nature and, therefore, authorized for FHCs to engage in pursuant to the GLBA.[20] The following activities are listed as activities defined as financial in nature and therefore permissible for an FHC to conduct directly or indirectly:

(a) *Activities previously determined to be closely related to banking.* Activities determined by regulation or order of the Federal Reserve Board prior to November 12, 1999 to be closely related to banking for purposes of Section 4(c)(8) of the Bank Holding Company Act. The activities determined to be closely related to banking for this purpose are listed in the rule as follows:
   i. Providing administrative and other services to mutual funds;
   ii. Owning shares of a securities exchange;
   iii. Providing employment histories to third parties;
   iv. Check cashing and wire transmissions services;
   v. Providing notary public services;
   vi. Selling postage stamps and postage-paid envelopes;
   vii. Providing vehicle registration services, and selling public transportation tickets and tokens in connection with offering banking services;
   viii. Real estate title abstracting; and
   ix. Acting as a certification authority for digital signatures, including authenticating the identity of persons conducting financial and nonfinancial transactions abroad.

   These activities must be conducted in accordance with the terms and conditions contained in Regulation Y, promulgated by the Federal Reserve Board pursuant to the Bank Holding Company Act of 1956, as amended, and the Board's orders authorizing the activities, except as they may be modified by the Federal Reserve Board.

(b) *Activities usual in connection with the transaction of banking abroad.* Pursuant to the GLBA, activities that are financial in nature [sic] includes the following three activities that the Federal Reserve Board had determined, prior to November 11, 1999, to be usual in connection with the transaction of banking or other financial operations abroad:
   i. Management consulting;
   ii. Operating a travel agency in connection with the offering of financial services; and
   iii. Organizing and sponsoring a mutual fund.

   These activities must be conducted in accordance with the limitations on scope and conduct set forth in Regulation K of the Federal Reserve Board.

(c) *Other activities defined as financial in nature.* The GLBA permits the Federal Reserve Board, in consultation with the Secretary of the Treasury, to determine that additional activities are financial in nature or incidental thereto. By rule, the Federal Reserve Board determined that acting as a finder is incidental to a financial activity.[21]

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20. Bank Holding Companies and Change in Bank Control (Regulation Y) Regulations, 12 C.F.R. § 225 (2001).

21. *Id.* § 225.86.

6. *Operating Subsidiaries of Foreign Banks*

On December 5, 2000, the Office of the Comptroller of the Currency (OCC) published a proposed regulation that would allow foreign banks to establish operating subsidiaries in the United States under rules similar to those that govern the establishment of operating subsidiaries of U.S. banks.[22] The intention of the proposed rules was to permit foreign banks to compete with U.S. banks on equal footing.

7. *Expansion of Ability of State Member Banks to Conduct Activities Through Subsidiaries*

On August 16, 2000, the Federal Reserve Board issued a legal interpretation expanding the ability of state-chartered banks that are members of the Federal Reserve System to invest in subsidiaries. Prior to this interpretation, which is embodied in a letter to the Chase Manhattan Bank, the Federal Reserve Board maintained the position that such investments were permitted only where the bank owned 100 percent of the subsidiary's voting stock. Section 121 of the GLBA, however, uses the definition of subsidiary set forth in the Bank Holding Company Act, which provides that a company is a subsidiary if 25 percent of its voting stock is owned by the parent, the parent controls the election of a majority of the company's board of directors, or the Federal Reserve Board otherwise determines that the company is controlled by the parent. Based on the GLBA's adoption of this definition of subsidiary, the Federal Reserve Board determined that a state member bank may acquire as an operations subsidiary any company that meets the definition of a subsidiary, and engages only in activities permissible for the state member bank, under the same terms and conditions that govern the conduct of the activities by the state member bank.

8. *Financial Activities of National Banks*

Effective March 11, 2000, the OCC promulgated a final rule expanding national bank activities through financial subsidiaries, new equity investments, and operating subsidiaries.[23] With respect to financial subsidiaries authorized by the GLBA, the OCC permits national bank investment if the national bank is well capitalized and well managed. Consolidated total assets of all the bank's financial subsidiaries are subject to an aggregate limit of the lesser of $50 billion or 45 percent of the bank's consolidated total assets.[24] Also, national banks that are among the 100 largest insured banks must meet certain requirements on their outstanding debt, unless the financial subsidiary acts solely as an agent, rather than as a principal. Financial subsidiaries of national banks are not permitted to engage in the following activities:

(a) Provide annuities and certain types of insurance as principal;
(b) Engage in real estate development or investement, except under limited circumstances; and
(c) Conduct certain activities allowed for financial holding companies, such as merchant banking.

The rule expedites the procedure for national banks engaging in new activities through an operating subsidiary by permitting the bank to file a notice within ten days after com-

22. Operating Subsidiaries of Federal Branches and Agencies, 65 Fed. Reg. 75,870 (proposed Dec. 5, 2000) (to be codified at 12 C.F.R. pt. 5).

23. Rules, Policies, and Procedures for Corporate Activities, 12 C.F.R. § 5.39 (2001).

24. *See id.* § 5.39(g)(2).

mencing the activity, so long as the bank is well capitalized and well managed. The previous requirement called for prior approval by the OCC.

B. Privacy

1. *Federal Banking Regulations*

The federal banking regulatory agencies (the FDIC, Federal Reserve Board, OCC, and the Office of Thrift Supervision) promulgated interagency regulations on financial privacy, as required by Section 504 of the GLBA on May 10, 2000, two days in advance of the May 12 deadline.[25] By statute, these rules were to become effective on November 13, 2000, and, although they were effective on that date, the regulatory agencies made compliance voluntary until July 1, 2001, because of widespread concern that banking institutions would need more time to comply with the rules.

The privacy rules require financial institutions to disclose to consumers their policies on handling consumers' nonpublic personal information, including whether and to what extent such information may be provided to affiliates and nonaffiliated third parties. The disclosure must also give each consumer an opportunity to opt out of disclosures to nonaffiliated third parties, thereby prohibiting the financial institution from transmitting the consumer's nonpublic personal information to nonaffiliated third parties, except in certain cases. Significantly, the privacy rules treat applicants for financial services as consumers, and require the disclosure and opportunity to opt out for consumers as well as actual customers (i.e., consumers who actually establish a customer relationship with the institution) of the institution.

Consumers must be provided with the notice and opportunity to opt out (a) at the time a customer relationship is established, and (b) for consumers who are not customers, prior to disclosing nonpublic personal information about the consumer to a nonaffiliated third party. It should be noted that an institution may avoid all of its obligations to consumers who are not customers of the institution by electing not to disclose consumer information to nonaffiliated third parties. However, with respect to customers, the disclosure and opt-out requirements continue on an annual basis for the duration of the customer relationship with the financial institution.

Customer relationship is defined by the agencies as a "continuing relationship between a consumer and a financial institution whereby the institution provides a financial product or service that is to be used by the consumer primarily for personal, family, or household purposes."[26] However, even a one-time transaction may be considered a "continuing relationship" depending on the nature of the transaction. Conversely, a series of isolated transactions, such as withdrawals from an ATM machine, would not establish a continuing relationship and make a consumer a customer.

Nonpublic personal information is defined by the GLBA to mean personally identifiable financial information provided by a consumer to a financial institution, results from any transaction with the consumer, or any service performed for the consumer, or is otherwise obtained by the financial institution including any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived using any

25. Privacy of Consumer Financial Information, 12 C.F.R. § 40 (2001); Privacy of Consumer Financial Information (Regulation P), 12 C.F.R. § 216 (2001); Privacy of Consumer Financial Information, 12 C.F.R. § 332 (2001); Privacy of Consumer Financial Information; 12 C.F.R. § 573.4 (2001).

26. *Id.* § 573.3.

nonpublic personal information other than publicly available information. The rules define publicly available (and therefore not nonpublic personal information) as information that the financial institution has a reasonable basis to believe is lawfully made available to the general public from one of three categories of sources: federal, state, or local government record; widely distributed media; or disclosures to the general public that are required to be made by law. Personally identifiable financial information is defined to include information provided by a consumer to a financial institution in order to obtain a financial product or service, information resulting from any transaction between the consumer and the financial institution involving a financial product or service, and information about a consumer otherwise obtained in connection with providing a financial product or service to the consumer. This broad definition would include information that is not strictly financial in nature, such as health-related information.

In adopting the privacy rules, the agencies considered whether and to what extent they should apply to foreign institutions. Ultimately, the agencies determined that the rules would apply to foreign institutions with offices in the United States, but not to offshore offices of financial institutions.

As part of the privacy rules, the regulatory agencies provided model language that may be used on disclosure forms. The privacy rules contain many specific provisions and examples that must be reviewed carefully by any financial institution with offices in the United States in preparing for and continuing to comply with the privacy requirements, which become mandatory on July 1, 2001.[27]

2. *SEC Rules*

On June 22, more than a month after the statutory deadline, the Securities and Exchange Commission (SEC) issued privacy rules for the securities industry pursuant to the privacy provisions of the GLBA.[28] These rules, designated as Regulation S-P, govern the circumstances under which securities brokers, dealers, investment companies, and investment advisers may transmit nonpublic personal financial information about their customers to third parties. The SEC privacy rules are substantially similar to the privacy rules jointly issued by the federal bank regulatory agencies described above.

3. *State Legislation*

Approximately twenty states adopted or proposed privacy legislation during 2000. As described above, the GLBA provided privacy protection, but did not preempt, and in fact invited, state efforts to adopt more restrictive measures of privacy protection. Many of the state proposals mirrored the "opt-out" provisions of the GLBA, but others adopted an "opt-in" approach, effectively prohibiting financial institutions from transmitting to third parties nonpublic financial information gathered from consumers without express authorization from the consumer. Several states restricted such transmissions to affiliates, as well as non-affiliates, and others, such as New York (which is described below), provided different treatment for different types of information.

27. *E.g.*, 12 C.F.R. § 573, App. A.

28. Privacy of Consumer Financial Information (Regulation S-P), 17 C.F.R. § 248 (2000).

4. *Extension of Privacy Rules Compliance Date by Federal Regulators and State Insurance Commissions*

Concerned that financial institutions would not be able to comply with the privacy requirements of the GLBA, the federal banking regulatory agencies adopted their privacy regulations with the required effective date of November 13, 2000, but made compliance voluntary until July 1, 2001.

5. *NAIC Model Number 672: Model Law to Protect Privacy of Financial and Health Data; NAIC Model Privacy Regulations*

The National Association of Insurance Commissioners adopted both model legislation and model regulations for the protection of consumer financial and health information. These models are essentially reflected in the privacy rules adopted by the New York Insurance Department as discussed below. They attempt to provide a uniform standard for states to apply to the disclosures and opt-out provisions of the GLBA with respect to nonpublic personal financial information, and to the protection of health related information through disclosure and opt-in provisions that restrict the ability to disclose health information, even to affiliates.

6. *New York Privacy Rules Issued November 9, 2000*

The New York State Insurance Department issued regulations to address customer privacy issues and implement the privacy provisions of the GLBA.[29] Regulation No. 169 requires that insurers provide an annual opt-out election to customers that would prevent the insurer from sharing customer information with nonaffiliated third parties. The annual election must also include a notice of the insurer's privacy policy with respect to financial information concerning the customer.

New York extended the customer's privacy rights further than the GLBA, however, by differentiating between nonpublic personal health information and other nonpublic personal information. Pursuant to the regulations, nonpublic personal health information cannot be disclosed, either to affiliates or to third parties, without the express consent of the customer. Therefore, although the common opt-out requirement applies to nonpublic personal financial information allowing the insurer to disclose such information unless the customer indicates an objection, nonpublic personal health information cannot be disclosed unless the customer specifically authorizes the insurer to do so. The New York Insurance Department distinguished between the two types of nonpublic personal information because of "the uniquely personal nature of health information."[30] With respect to nonpublic personal financial information, the regulation is effective July 1, 2001. The ban on unauthorized disclosure of nonpublic personal health information becomes effective December 31, 2001.

7. *U.S. Agreement with EU on Privacy*

On November 1, 2000, the United States implemented a safe harbor agreement in order to comply with the data privacy rules adopted in 1998 by the European Union (EU), as further described in section IV below. The U.S. banking and insurance industries have

29. Privacy of Consumer Financial and Health Information, N.Y. Comp. Codes R. & Regs. tit. 11, § 420 (2000).

30. *Id.* § 420.3(S).

argued that the privacy provisions of the GLBA and other applicable requirements and restrictions that apply to the use and transmission of consumer information by U.S. financial institutions result in compliance with the EU rules. Nonetheless, the United States and the EU reached the safe harbor agreement in order to protect U.S. companies against business interruption or prosecution by the EU.

C. E-Commerce/E-Signatures

On June 30, 2000, President Clinton signed the Electronic Signatures in Global and National Commerce Act (E-Sign Act),[31] which became effective October 1, 2000, except for the record retention rules that had an effective date of March 1, 2001. Fundamentally, the E-Sign Act provides that signatures and contracts cannot be denied legal effect or enforcement due to the fact that they are electronic in form. Although no specific existing laws are addressed, the E-Sign Act provides that existing laws cannot be applied to invalidate electronic contracts and signatures.

The E-Sign Act also sets forth standards and conditions for the enforceability of electronic signatures and contracts. For example, the contract must be able to be retained and printed by both parties, the mechanism for transmitting the documents for signature must have safeguards to assure the identity of the parties and the integrity of the contents of the documents, and legally required disclosures may be made electronically only if the party to whom the disclosure is to be given affirmatively consents to receiving the disclosure in electronic form.

Certain specified types of documentation are excluded from the E-Sign Act and its preemption of legal requirements for hard copies and live signatures.[32] For example, state law requirements pertaining to the execution of documentation in family law matters, wills and trusts, court papers, filings with governmental agencies, and certain notices such as defaults involving a primary residence and certain product recalls, are not covered by the E-Sign Act. They must, therefore, continue to comply with applicable requirements for documentation, execution, and delivery.

As a result of the E-Sign Act, over the next few years state legislatures and state and federal agencies will continue their efforts in developing standards for contracting parties engaged in e-commerce in order to ensure the security, integrity, and reliability of electronically documented transactions.

D. Enhancements to Foreign Bank Supervision

On October 23, 2000, the Federal Reserve Board announced that it was streamlining the interagency program supervising the U.S. operations of foreign banks.[33] The Federal Reserve Board will share its Strength of Support Assessment (SOSA) rankings, which were reduced from five to three, with the senior managers of foreign banks and the banks' home country supervisors. SOSA rankings have been used since 1995 to assess a foreign bank's

31. Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001 (2000).
32. *See id.* § 7003.
33. Guidelines for Implementing the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (the FBO Supervision Program), Federal Reserve System SR00-14 (Oct. 23, 2000), *available at* http://www.federalreserve.gov/boarddocs/SRLETTERS/2000/SR0014.htm.

support of its U.S. operations. The SOSA rankings will also be updated more frequently; at least annually, and more often as needed due to significant events.

The Federal Reserve Board also created a new combined assessment rating of risk management, operational controls, compliance, and asset quality (referred to as ROCA) for all of a foreign banking organization's U.S. branches, agencies, and commercial lending companies.

II. Brazil

The following is an update on the major significant legal developments in the banking and financial services area in Brazil, and main related capital market issues during the year 2000.

A. Foreign Investments in the Brazilian Financial and Capital Markets

The Brazilian Monetary Council[34] approved new rules dealing with the investments made in the financial and capital markets by non-Brazilian resident investors (i.e., any individual or financial or non-financial institution, resident or domiciled outside Brazil). These rules are contained in Resolution No. 2689[35] (January 26, 2000) issued by the Central Bank of Brazil (Bacen).[36] Resolution No. 2689 foresees the nomination of a representative in Brazil before initiating the operations and the need for a registration with the Brazilian Securities and Exchange Commission (CVM).[37] The investment must be registered with Bacen. If the legal representative of the foreign investor is an individual or non-financial institution, this foreign investor should also indicate a financial institution domiciled in Brazil as the legal representative jointly and severally responsible for certain administrative duties, including that of advising Bacen and CVM on any irregular action taken by the foreign investor.

Resolution No. 2689 forbids the use of funds that entered into Brazil under the rules of this Resolution in any securities market operation resulting from the purchase or disposal (a) in a place other than the floor of a stock exchange, electronic systems or over-the-counter markets organized by any entity authorized by CVM, of stocks of publicly-held corporations listed for trading in such markets; and (b) of stocks and securities traded in over-the-counter markets either unorganized or organized by entities not authorized by CVM. However,

34. The Brazilian Monetary Council (*Conselho Monetário Nacional*—CMN) is the highest authority in the financial and capital markets and was created by Law No. 4595, December 31, 1964. It is a *collegium* body, whose president is the Finance Minister, being further formed by the Planning and Budget Minister and the President of the Central Bank of Brazil. It is a regulatory body that formulates policies, having no executive or administrative functions.

35. Registration of Foreign Investors, Central Bank of Brazil Resolution No. 2689 (Jan. 26, 2000), *available at* http://www.amorastuber.com/legislation.

36. The Central Bank of Brazil (*Banco Central do Brasil*-Bacen) was also created by Law No. 4595, December 31, 1964. It is an independent federal entity, whose prime function is to enact and enforce the rules issued by the Brazilian Monetary Council. Except for securities and their respective markets, which are subject to the supervision by the Brazilian Securities and Exchange Commission, all other markets are supervised by the Central Bank of Brazil.

37. The Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários*—CVM) was created by Law No. 6385, December 7, 1976. It is an independent government entity associated with the Finance Ministry in charge of overseeing the securities and their respective markets and exercises its powers in conjunction with the Brazilian Monetary Council.

this prohibition does not apply to subscription, granting of bonus, conversion of debentures into stocks, indices referenced to stocks, purchase and disposal of quotas of securities and stocks investment open funds, and, as provided previously authorized by CVM, to cases of capital closing and trade cancellation and suspension.

Furthermore, the Brazilian Monetary Council expressly allows individuals and entities domiciled abroad, as well as foreign investment funds and collective investment entities, to conduct transactions in the Brazilian Future and Commodities Exchange (*Bolsa de Mercadorias e Futuros*) in connection with forward, future and option agreements referenced in farming and cattle raising matters, as per provisions in Resolution No. 2687 (January 26, 2000) issued by Bacen.[38]

It should also be noted that the Brazilian Monetary Council allowed foreign investors to contract the local currency exchange directly with the Brazilian Clearing and Custody House (CBLC), the Clearing House of the São Paulo Stock Exchange (Bovespa). These rules are contained in Resolution No. 2786 (October 18, 2000) issued by Bacen.[39] The main advantage of this incentive is that it exempts foreign investors from the payment of the Provisional Contribution on Financial Transactions (CPMF) whenever buying or selling stock. Once the CBLC is legally tax-exempted, such financial transactions are less costly. Prior to the issue of this Resolution, foreign investors had to pay 0.3 percent CPMF on each financial transaction they engaged in on the Brazilian stock markets. In other words, they would pay 0.6 percent to buy and sell a certain stock.

Presently, foreign investors can buy stock on the Brazilian stock market and pay for it in U.S. dollars abroad. The CBLC will receive the credit from the correspondent institution abroad and pay the stock offeror in Brazilian currency, real. This also applies when foreign investors sell their stock on the local market and the credit will be posted abroad in the corresponding currency.

B. Securitization of Receivables

The Brazilian Monetary Council authorized the assignment of credits originated from any operation performed by multiple banks, commercial banks, investment banks, credit institutions, financial and investment institutions, mortgage companies, loan and savings associations and the Federal Government Savings Bank to Special Purpose Companies (SPC). SPCs are corporations with a main objective for the acquisition of credits. The new rules were adopted pursuant to Resolution No. 2686 (January 26, 2000) issued by Bacen,[40] and modify the regulation of securitization of receivables in Brazil, and revoked by Resolution No. 2493 (May 7, 1998). The main changes may be outlined as follows:

1. The securitization of real-state receivables, is now subject to Resolution No. 2686 as a result of the revocation of Resolution No. 2573 (December 17,1998).
2. The assignment of credits originated from any transaction for securitization purposes. The Assignment is allowed, as long as such credits are handled by the institutions

38. Central Bank of Brazil Resolution No. 2687 (Jan. 26, 2000), *available at* http://www.amarostuber.com/legislation.

39. Central Bank of Brazil Resolution No. 2786 (Oct. 18, 2000), *available at* http://www.amorstuber.com/legislation.

40. Central Bank of Brazil Resolution No. 2686 (Jan. 26, 2000), *available at* http://www.amorstuber.com/legislation.

listed in Resolution No. 2686. Formerly, only credits originated from loan, financing and leasing transactions, executed by financial institutions and other entities could be securitized. Leasing companies were excluded from the list of entities that could assign their credits to SPCs.

3. The prohibition that was extinguished related to the fund raising by the SPCs in Brazil for credits acquired by the SPCs subject to exchange variation.
4. The entity that is assigning the credits to be securitized is authorized to conduct the credit assignment transaction with co-obligation.

C. Foreign Currency Bank Accounts

The Brazilian Monetary Council authorized the opening and operation of bank accounts in foreign currency titled by insurance companies, local reinsurance companies, admitted reinsurance companies, and broker reinsurance companies. This authorization has been granted through Resolution No. 2694 (February 24, 2000) issued by Bacen.[41] Basically, this Resolution establishes that: (a) in order to intervene in an insurance or reinsurance foreign currency agreement, these companies must have foreign currency accounts in Brazil (the operation of these accounts is restricted to the transit of reinsurance, premium, and indemnity amounts related to foreign currency agreements), and (b) the premium and the indemnity related to insurance or reinsurance agreements entered into in a foreign currency will be paid by bank transfer in the currency indicated therein.

D. Brazilian Depositary Receipts

Brazilian Depositary Receipts (BDR) are certificates representative of securities issued by publicly held companies incorporated abroad and issued by a depositary institution in Brazil. The depositary institution must be a financial entity duly authorized to operate within the Brazilian territory by Bacen. CVM altered the rules that govern the issue of BDRs for the purpose of lifting all restrictions that affected foreign Internet companies interested in issuing BDRs. CVM Instructions Nos. 255 (October 31, 1996) and 321 (December 10, 1999) have been revoked, and CVM Instructions Nos. 331 and 332 (April 4, 2000)[42] are now in effect.

Previously, any foreign company interested in issuing BDRs would have to prove a three-year minimum operation in the country. A significant change in relevant legislation, made possible through CVM Instruction No. 331, allows the issue of certificates by newly organized companies in the Brazilian market.

Another restriction revoked was the requirement of a company's net asset value to be greater than the amount of the planned distribution. CVM Instruction No. 331 addresses the registration of companies with the CVM in order to be authorized to issue BDRs. CVM Instruction No. 332 provides exclusively for the registration of foreign companies interested in issuing certificates in the Brazilian market.

Furthermore, the Brazilian Monetary Council changed the rules that govern the investments made by Brazilian residents in the foreign stock markets. According to Resolution

41. Central Bank of Brazil Resolution No. 2694 (Feb. 24, 2000), *available at* http://www.amorstuber.com/legislation.
42. CVM Instructions Nos. 331, 332 (Apr. 4, 2000), *available at* http://www.amorstuber.com/legislation.

No. 2763 (August 9, 2000) issued by Bacen,[43] Brazilian investors can purchase stock of foreign companies directly from the stock markets abroad, as long as these companies issue BDRs in Brazil. All Brazilian investments in foreign markets are subject to registration with Bacen, which will control and ensure that funds are remitted for investment purposes, the respective return of such funds increased by any capital gain and the applicable taxation to capital gain.

Foreign investors also benefited with the alterations announced by Bacen. In the event the issue of a BDR is cancelled, foreign investors no longer need to get rid of their shares in order to bring funds back into Brazil. They can now keep their shares in foreign markets. However, Brazilian investors still must sell their shares and bring the funds into Brazil within seven days from the date of BDR issue cancellation.

Brazilian investors could only acquire shares of foreign companies through BDRs that were traded in Brazil. The new rule allows Brazilian investors to participate in both international and domestic markets and choose the best value for their investment.

E. Establishment of Brazilian Financial Institutions Abroad

The new rules approved by the Brazilian Monetary Council as Bacen Resolution No. 2723 (May 31, 2000),[44] provide the conditions and procedures for the establishment of Brazilian financial institutions abroad.

The opening of branches and representative offices abroad by Brazilian financial institutions, as well as their direct or indirect participation in foreign and domestic financial institutions, depend on the previous authorization by Bacen. These branches and offices are subject to several conditions on the part of the participating institution, among which: (a) it must be in operation for at least six years; (b) it must meet the operational limits established by current regulation; and (c) it must submit a financial-economical feasibility study of the branch/office to be established or of the investment to be made, including the planned operational strategy and the profit/return on investment forecast.

The financial institutions interested in undertaking such operations must elaborate their consolidated financial reports to include the participation in domestic or foreign institutions in which they hold, directly or indirectly, voting power, authority to appoint or dismiss administrators, operational control characterized by the administration or management, or use of the trade name or brand.

Direct or indirect investments in securities, through pension funds, will be considered as shareholding by this Resolution and must be proportionally consolidated in the following cases: (a) enterprises located in Brazil, except the ones mentioned above; (b) enterprises in which the control is shared with other conglomerates, whether financial or otherwise; (c) public companies; (d) institutions in which the control is shared by institutions part of different financial conglomerates subject to the supervision of Bacen; and (e) enterprises located abroad in which the existing control is shared by other conglomerates, whether financial or otherwise.

The following procedures also depend on prior authorization from Bacen: (a) allocation of new resources to branches and offices located abroad; (b) increase of capital of financial

43. Central Bank of Brazil Resolution No. 2763 (Aug. 9, 2000), *available at* http://www.amorstuber.com/legislation.

44. Central Bank of Brazil Resolution No. 2723 (May 31, 2000), *available at* http://www.amorstuber.com/legislation.

institution or company object of share ownership, directly or indirectly, located abroad; and (c) spin-off, incorporation and merger of financial institution object of share ownership, directly or indirectly, abroad.

Any involvement in shareholding of a company located abroad or its partial or total sale, as well as the start-up/end of activities of a branch or office abroad, must be reported to the Bacen within thirty days of occurrence.

F. Electronic Registration of Foreign Direct Investments in Brazil

The Brazilian National Monetary Council introduced rules for the first time regarding the electronic registration of foreign direct investments in Brazil, through the Information System of Bacen (Sisbacen). These rules are contained in Circular No. 2997 (August 2, 2000) issued by Bacen.[45] In the past, foreign capital registration involved a very time-consuming and bureaucratic procedure consisting of extensive paperwork filing.

Foreign direct investment is defined by the new rules as any participation in the capital of companies owned by individuals or corporations that are resident, domiciled, or head-quartered abroad, established or acquired according to the legislation in effect, and includes the capital of foreign companies authorized to operate in Brazil. However, participation of non-resident investors acquired in stock and capital markets, as well as profits earned on such investments, are under this definition because they are subject to specific rules.

According to the provisions of such Resolution, foreign direct investments encompass the following items, among others: (a) currency investments; (b) investments in tangible or intangible assets; (c) conversion into direct investment of rights and/or credits to be remitted abroad; (d) reinvestment of profits, and interest earned on own capital; (e) reinvestment of profits of previous direct investments; (f) reorganization of companies due to amalgamation, merger and acquisition, and spin-off; and (g) economic and financial information.

The local representatives of the Brazilian recipient company to receive the investment and of the non-resident investor must file for electronic registration of the direct investment with Bacen through Sisbacen. This registration is mandatory and considered a requirement for any international transfer of funds.

G. Foreign Currency Loans in Brazil

The Brazilian government also decided to adopt a simpler and less bureaucratic system to allow private-sector companies to seek foreign loans. This system enables private-sector borrowers to access, at any time they may deem convenient, the international market to search for investment opportunities and fees and interest rates that best meet their needs. In this regard, the Brazilian Monetary Council established new rules to allow private companies and financial institutions to obtain loans abroad without needing any previous authorization from Bacen. These new rules are contained in Resolution No. 2770 (August 30, 2000) issued by Bacen.[46]

Another great benefit this measure brings about is the reduction of the so-called "Cost-Brazil." Nowadays, the registration of loan transactions is done by the bank charged with

45. Central Bank of Brazil Circular No. 2997 (Aug. 15, 2000), *available at* http://www.amorstuber.com/legislation.

46. Central Bank of Brazil Resolution No. 2770 (Aug. 30, 2000), *available at* http://www.amorstuber.com/legislation.

the closing of exchange (i.e., conversion of foreign funds into Brazilian currency) within ten business days from the date the money enters Brazil. It will also be the bank's responsibility to pass on the information to Bacen.

Along with the above-mentioned changes, the Brazilian Monetary Council revoked 237 norms that were part of a set of rules governing foreign exchange transactions since the early 1960s, although some of them were no longer in effect. Additionally, Bacen determined that these financing transactions do not need to follow the old destination rules and can now have free destination. However, the tax on financial transactions (IOF), which is 5 percent on transactions of terms of less than ninety days, was not altered. The government holds the right to alter the term and rate of IOF in case it identifies concentration of transactions in the same period of time.

H. Public Take-Over Bids

CVM issued Instruction No. 345 on September 4, 2000,[47] which deals with public take-over bids. According to this Instruction, in the case of public take-over bids, the approval request must be followed by a description of the number and percentage of minority shareholders that agreed with the capital closing or by any other favorable manifestation in this sense.

The public offer will be irrevocable and must target the totality of the shares available in the market. The capital closing will only occur if at least 67 percent of the minority shareholders accept the public take-over bid or if they expressly agree with the registration cancellation. The information contained in this article is accurate. The rule should be reviewed by CVM this year because it is creating so many problems in practice.

Regarding the public offer notice, it must expressly state that it is a public take-over bid conditioned upon the fulfillment of the registration cancellation requirement, also specifying if the offeror will make use of the right to acquire up to one-third of the shares available in the market should the cancellation requirement fail to be met.

Should registration fail to be cancelled, the controlling shareholder will be unable to start a new public take-over bid within two years from the date of publication of the last offer's result. The financial institution that mediated the offer must inform the CVM, the public, and those related to the shareholders that have accepted the offer of the number and percentage of the shares acquired by the controlling shareholder. The shareholders that did not sell their shares during the validity term of the offer can sell within six months from the shareholders meeting that approved the financial statements of the first corporate period after the registration cancellation. This option can be exercised before both the financial institution and the company.

The rights of minority shareholders are protected. While proceeding with a public take-over bid, should minority shareholders that own, in the aggregate, more than one-third of shares qualify, the offeror must publish it in the public offer, in addition to the minimum and maximum numbers of shares that the offer is willing to acquire: (a) if the offer is terminated; (b) if the offer acquires proportionally the shares of those who agreed with the offer, up to one-third of the shares available in the market; and (c) if the offer starts a new proceeding of a public take-over bid, observing the rules of CVM Instruction No. 229[48] (January 1, 1995), whether or not keeping the publicly held company registration.

47. CVM Instruction No. 345 (Sept. 4, 2000), *available at* http://www.amorstuber.com/legislation.

48. Publicly Held Companies, Central Bank of Brazil Instruction No. 299 (Feb. 9, 1999), *available at* http://www.amorstuber.com/legislation.

The offers eventually accomplished within the two-year period from the publication of the results of the first offer, are subject to an aggregate limit of one-third of the shares that were available in the market on the date of the first offer of each cycle. Once this limit is achieved and before the two-year term is finished, new offers may take place under the rules of CVM Instruction No. 229, with the possibility to keep the publicly held company registration.

III. Canada

The Canadian financial services sector saw a number of significant federal legislative developments in 2000, including: (a) significant new federal legislation that will, among other things, encourage new investment in and by Canadian banks and demutualized life insurance companies, permit banks and life insurers to organize under regulated holding companies, and establish merger rules for large Canadian banks; (b) proposals to revise the tax regime affecting foreign bank branches (FBB) in Canada, (c) general legislation establishing a new right to privacy; and (d) new anti-money laundering legislation.

A. New Investment Opportunities in Canadian Banks and Demutualized Life Insurance Companies

On June 13, 2000, after several years of policy review, the Canadian government introduced significant amendments to federal financial institutions legislation in Parliament as a component of a new financial services policy framework.[49] Although this legislation died on the order paper when a Canadian election was called for November 2000, the legislation was reintroduced in Parliament on February 7, 2001, in substantially the same form (the "Bill"). It is expected to be enacted as early as June 2001.[50] When enacted, the Bill will establish a new ownership regime for federally regulated financial institutions, allow banks and life insurance companies to organize under regulated holding companies, and expand the range of permitted investments by these entities. Most commercial entities will be able to take substantial ownership positions in Canadian banks. The rules affecting foreign banks in Canada will be revised. The payment system will be open to life insurance companies, securities dealers, and money market mutual funds. A new federal consumer agency will be created to monitor institutional compliance with federal consumer protection measures. Additional disclosure and reporting requirements will be imposed on financial institutions.

The new ownership rules seek to promote growth and foster increased competition in the Canadian market. Financial institutions will have greater opportunities to enter into joint ventures. The holding company rules will offer more flexibility in structuring operations, providing latitude for raising capital and entering into strategic alliances.

1. *Ownership Rules for Banks*

Different ownership restrictions will apply to three classes of banks and bank holding companies (BHC), based on the size of their equity:

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49. Financial Consumer Agency of Canada Acts, Bill C-38, 36th Parliament, 2d Sess. (2000), *available at* http://www.parl.gc.ca/36/2/parlbus/chambus/house/bills/government/c-38/c-38_1/90108bE.html.The framework included not only the Bill's legislative revisions, but also the implementation of certain non-legislative measures, such as guidelines and statements of government policy.

50. The reintroduced legislation in the current Parliament is Bill C-8 [hereinafter Bill C-8].

(a) large banks and BHCs with equity of $5 billion[51] or more;
(b) mid-sized banks and BHCs with equity of $1 billion or more, but less than $5 billion; and
(c) small banks and BHCs with equity of less than $1 billion.[52]

The current ownership rules, which distinguish between widely held domestic Schedule I banks and closely held domestic and foreign-owned Schedule II banks, will disappear. Once the Bill is enacted, all Canadian banks will be listed in Schedule I, and all foreign bank subsidiaries in Canada will be listed in Schedule II of the Bank Act. Foreign bank branches will continue to be listed in Schedule III of the Bank Act.

Generally, ministerial approval will be required for a person to acquire a "significant interest" (more than 10 percent) in any class of shares of a bank or BHC. Where, as a result of an amalgamation, merger, or reorganization, an entity would have more than 10 percent of any class of shares of a bank or BHC, it shall be deemed to be acquiring a significant interest and must obtain the approval of the Minister of Finance (Minister). Canada's existing large banks will continue to be widely held. It is important that the current restriction on widely held banks having any shareholder with a significant interest in any class of their shares will disappear. Subject to an investor meeting a new "fit and proper" test and the approval of the Minister, the investor will be permitted to hold over 10 percent and up to 20 percent of any class of voting shares or over 10 percent and up to 30 percent of any class of non-voting shares of a large bank.[53] This more flexible approach is designed to encourage strategic alliances and joint ventures. A new definition of "widely held" will apply; a widely held institution may not have a "major shareholder," an investor holding more than 20 percent of voting shares or 30 percent of a class of non-voting shares.

The National Bank of Canada, the Laurentian Bank of Canada, and the Canadian Western Bank, all banks with equity of less than $5 billion, will be deemed to be large banks. Consequently, these mid-sized banks also cannot be acquired or have a major shareholder. The Minister, however, will have the power to re-categorize these banks as mid-sized, presumably so long as their equity size does not reach the large bank threshold. As a matter of policy, the Minister will consider regional interests when determining whether to recategorize these entities as mid-sized, thereby making them eligible to be acquired. A recategorization would be subject to a public review process. New guidelines have been announced for ministerial review of a transaction, such as a merger, that would involve the recategorization of one of these banks.

Generally, a bank that surpasses the "large" threshold through growth or acquisition may meet the widely held requirement through a widely held Canadian or foreign financial institution parent, or regulated bank or BHC, or insurance holding company (IHC) that holds the bank when it becomes large. Nevertheless, while any of the existing "Big Five" large banks may be controlled by a widely held regulated BHC created through a share exchange or proposal mechanism, other widely held entities would not qualify to hold these large banks. Other rules will also apply to restrict shareholder influence over banks to preserve the principle of wide ownership.

51. All dollar figures in this section are in Canadian dollars.
52. Bill C-8, *supra* note 50, pt. 15, no. 98.
53. *See id.* no. 98, § 396.

A major shareholder, including banks, other domestic or foreign financial institutions, and commercial enterprises will be able to hold up to 65 percent of the voting shares of a mid-sized bank. The remaining 35 percent of the voting shares of a mid-sized bank must be publicly traded on a Canadian stock exchange and may not be owned by a major shareholder. No person will be able to acquire a significant interest in, or control in fact of, a mid-sized bank without the approval of the Minister. A person or entity affiliated with a person that engages in automobile leasing activities may not be a major shareholder of a bank.

There will be few ownership restrictions on shareholders of small banks. Commercial enterprises, other than ones that engage in automobile leasing activities, will be permitted to wholly own a small bank. Commercial owners will be subject to a pre-approval review of their financial resources, business experience, reputation, and the transparency of their corporate structure, among other things. Transitional ownership provisions will apply where institutions pass the $1 billion and $5 billion thresholds.

2. *Bank Holding Companies*

For the first time, domestic widely held banks may be held by regulated, non-operating holding companies incorporated under the Bank Act.[54] Holding company structures will give banks the choice of moving activities they currently conduct in-house or in a subsidiary to an affiliate of the bank. Depending on the activity, an affiliate of the bank owned by a BHC may be subject to lighter regulation than the bank.

The holding company option will permit banks greater structural flexibility to compete with regulated and specialized firms. Generally, the ownership restrictions applicable to BHCs are similar to those for banks, based on their equity size. Ministerial approval will be required for a person who acquires or increases a significant interest in a BHC.

3. *Ownership Rules for Insurance Companies*

The approval of the Minister is required for a person to acquire or increase a significant interest in any class of shares of an insurance company or IHC. These provisions are in the Insurance Companies Act now and apply to insurance companies generally. Most of the ownership provisions described below apply to mid-sized and large converted life insurance companies as indicated, except where they apply to insurance companies generally, also as indicated. A "converted" company means a mutual life insurance company that has been converted into a life insurance company with common shares.

Different ownership restrictions will apply to four classes of insurance companies, based on the size of their equity:

(a) large converted companies with equity of $5 billion or more before their conversion (Manulife and Sun Life);
(b) mid-sized converted companies with equity of $1 billion or more, but less than $5 billion before their conversion (Clarica and Canada Life);
(c) small insurance companies with equity of less than $1 billion; and
(d) large and mid-sized insurance companies that are not converted companies.

54. *Id.* pt. 15.

As the current Insurance Companies Act permits, with ministerial approval, a person may control in fact an insurance company. When the Bill becomes law, this will not be the case for large or mid-sized converted companies until after December 31, 2001.

A large converted company or its IHC must be widely held; it may not have a major shareholder (the same restriction that applies to large banks, discussed above). There are a number of very specific exceptions to this rule, however. A widely held insurance company (ICA Holdco) may "control in fact" a large converted company if the converted company was so controlled at the time of its conversion or if it acquired control through a share exchange or proposal. "Control in fact" is any direct or indirect influence that, if exercised, would result in control in fact of the entity. A widely held IHC incorporated under the Insurance Companies Act may also control a large converted company or an ICA Holdco that controls in fact a converted company, if the IHC acquired control through a share exchange or proposal, or the converted company was a subsidiary of an ICA Holdco that was continued as an IHC.

Importantly, after December 31, 2001, the Minister may make a "determination" to remove the restriction that no person, other than the above-mentioned entities, may be a major shareholder of a large converted company.

For mid-sized converted companies, unlike large converted companies, the ownership test is not whether the company is widely held (i.e., no major shareholder), but rather whether any person has a significant interest in the company. Until after December 31, 2001, no person may have a significant interest in a mid-sized converted company. Exceptions are made for an ICA Holdco or an IHC that controls in fact a mid-sized company.

An insurance company, other than a small company, must continuously ensure that the voting shares that carry at least 35 percent of the voting rights attached to all of the outstanding voting shares of the company are listed for trading on a recognized Canadian stock exchange. A major shareholder of the insurance company may beneficially own none of these publicly traded shares. Certain entities that meet the public holding requirement and that control an insurance company may apply to the Minister to exempt the company from the public holding requirement.

4. *Insurance Holding Companies*

Although insurance companies generally may be held by unregulated holding companies, the Bill introduces a new regime for regulated IHCs of converted companies and other life insurance companies if they so choose. Generally, the ownership restrictions on IHCs are very similar to those for life insurance companies, based on the size of their equity.

Ministerial approval is required for a person to acquire or increase a significant interest in an IHC. After December 31, 2001, with ministerial approval, a person may have a significant interest in shares of an IHC that controls a mid-sized converted company. Like large converted companies, large IHCs must be widely held; they may not have a "major shareholder." After December 31, 2001, however, the Minister may determine that a person may be a major shareholder of a widely held IHC that controls in fact a large converted company. No person may have control in fact of an IHC without ministerial approval. Certain shareholding restrictions similar to those that apply to converted companies will limit shareholder influence over IHCs and their subsidiary life insurance companies.

Mid-sized and large IHCs will be required to list at least 35 percent of their voting shares on a Canadian stock exchange. A major shareholder of the IHC may not hold those publicly traded shares.

5. *Approval Process for Acquisitions*

The approval process for shareholders seeking to acquire a significant interest, majority shareholding or control of a bank, insurance company, BHC or IHC is substantially the same. Where a person seeks to hold a significant interest in any class of shares of one of these entities, the person must apply to the Minister. A person seeking to own more than 10 percent but less than 20 percent of the voting shares, or more than 10 percent but less than 30 percent of the non-voting shares of a large widely held bank, a large widely held BHC, or a large converted company, its ICA Holdco or widely held IHC will only be subject to a "fit and proper" test, which will take into account the applicant's character, integrity, and reputation.[55]

The Minister will consider a broader range of factors for persons seeking to hold a significant interest in, become a major shareholder of, or acquire a controlling interest in a bank, an insurance company, a BHC, or an IHC. The Minister will consider the following factors:

(a) the nature and sufficiency of the financial resources of the applicant as a source of continuing financial support;
(b) the soundness and feasibility of the plans of the applicant for the future conduct and development of the business of the entity;
(c) the business record and experience of the applicant;
(d) the character and integrity or reputation of the applicant;
(e) the competence and experience of the persons that will operate the entity;
(f) if the entity is a bank or, after December 31, 2001, a mid-sized or large converted company or an ICA Holdco controlling such a converted company, the opinion of the Superintendent regarding the extent to which the applicant's and its affiliates' corporate structure will affect the supervision and regulation of the entity;
(g) the impact of any integration of the businesses and operations of the applicant with those of the entity on the conduct of those businesses and operations (presumably, including the impact on employment); and
(h) the best interests of the financial system in Canada.[56]

Financial institutions from non-WTO countries will be required to demonstrate that Canadian financial institutions enjoy reciprocal treatment in their home jurisdiction before they will be permitted to control a Canadian financial institution subsidiary. New entrants into the Canadian financial services marketplace will be permitted to establish a financial institution with minimum capital of $5 million, subject to a "fit and proper test" before being granted a charter.

6. *Merger Review for Large Banks*

Following the failure of proposed Canadian bank mergers to receive ministerial approval in 1998, the Bill will establish a public merger review process for large banks. In addition to existing reviews of competition issues by the Competition Bureau and prudential issues by the Office of the Superintendent of Financial Institutions (OSFI) (Canada), merger proponents will be required to publish a Public Interest Impact Assessment, which will be

55. *Id.* pt. 15, no. 906.
56. *Id.*

reviewed by the House of Commons Standing Committee on Finance (Finance Committee) and the Standing Senate Committee on Banking, Trade and Commerce (Senate Committee). The Competition Bureau, OSFI, the Finance Committee, and the Senate Committee will report to the Minister. The Minister will consider whether to permit the merger to proceed and, if so, on what conditions.

Once the Bill is enacted, merger proposals may be forthcoming. The government will have the authority to impose appropriate sanctions to ensure compliance with terms and conditions imposed with respect to competition, prudential, or other public interest concerns.

B. Canada's Foreign Bank Branch Regime After One Year

On June 28, 1999, amendments to Canada's Bank Act came into force, which permit foreign banks to establish Canadian Foreign Bank Branches (FBBs) rather than operating through bank subsidiaries in Canada. Foreign banks have the option of choosing to establish either a "full-service" FBB or a "lending" FBB. Foreign banks with existing bank subsidiaries in Canada may choose to "convert" their subsidiaries to FBBs; deadlines have been established for "conversions" on a tax-deferred basis to be completed.

A key advantage that an FBB has over a bank subsidiary is that an FBB's lending limits are based on the aggregate capitalization of the foreign bank, whereas the lending limits of a bank subsidiary separately capitalized in Canada are based on the capitalization of the Canadian subsidiary.

FBBs face the same restrictions on their businesses and powers as Canadian banks, such as restrictions on insurance distribution and automobile leasing. Both a full-service branch and a lending branch may engage in consumer and commercial financing and other financial services activities permitted by Canadian banks, subject to certain exceptions. Both full-service and lending FBBs face restrictions on their sources of funding. A full-service FBB may borrow through the acceptance of deposits of $150,000 and over, but may not accept deposits of less than $150,000, subject to a 1 percent *de minimis* exception, and certain other exceptions prescribed by regulations. A lending FBB has more restrictive borrowing powers. It may not accept deposits or borrow in Canada or elsewhere, except from Canadian financial institutions and certain foreign banks, and they may not have access to Canadian commercial paper or bankers acceptance markets.

Nineteen foreign banks have made applications for approval to establish branches in Canada as of December 31, 2000.[57] As of December 31, 2000, five foreign banks have received all necessary regulatory approvals to operate full-service FBBs in Canada: The Chase Manhattan Bank, Mellon Bank, N.A., Morgan Guaranty Trust Company of New York, U.S. Bank National Association, and Capital One Bank. In addition, National City Bank has obtained all regulatory approvals to operate a lending FBB in Canada. Other foreign banks that are in the process of obtaining approvals include Bank One, Bayerische Landesbank Girozentrale, Credit Suisse First Boston, Deutsche Bank, Dresdner Bank, First Commercial Bank, Maple Partners Bankhaus, Rabobank, and State Street.

At the time that the amendments to the Bank Act concerning FBBs were introduced in the Canadian Parliament, proposed amendments to the Income Tax Act were released for

57. Information provided by Mr. Kim Norris, Director, Foreign Bank Branch Supervision, Office of the Superintendent of Financial Institutions (Canada).

comment. On August 8, 2000, the Department of Finance released detailed income tax proposals relating to the taxation of foreign banks that operate FBBs in Canada.[58] The proposals generally ensure that FBBs will be taxed in a manner similar to Schedule II bank subsidiaries. The proposals also contain provisions to facilitate the conversion of an existing bank subsidiary into a branch on a tax-neutral basis. This conversion tax relief is available on a time-limited basis. The Department of Finance has indicated that it expects to table the FBB tax proposals in Bill form in the early part of 2001. Ontario announced on February 6, 2001, that it intends to introduce parallel provincial FBB tax legislation once the federal FBB proposals have been enacted.

C. Personal Information Protection and Electronic Documents Act

On April 13, 2000, Canada's federal private-sector privacy legislation, the Personal Information Protection and Electronic Documents Act (PIPEDA), was enacted.[59] The purpose of the PIPEDA is to protect the privacy of personal information that is collected, used, or disclosed in the private sector, to permit business to be conducted with the federal government by electronic means, and to clarify how electronic records may be used as evidence. The Canadian government was motivated to draft the PIPEDA by the personal data protection standards of other jurisdictions, such as the 1995 European Union Directive on the Protection of Individuals in Relation to the Processing of Personal Data, which imposed restrictions on transborder data flows to jurisdictions without equivalent standards. The PIPEDA's purpose statement explicitly acknowledges the need to balance the right of privacy of individuals and the need of organizations to collect, use, and disclose personal information.

Part 1 and Schedule 1 (Schedule) to the PIPEDA are, with some significant exceptions, based on the ten privacy principles of the Canadian Standards Association Model Code for the Protection of Personal Information (CSA Standard).[60] The PIPEDA requires that an organization comply with the CSA Standard set out in the Schedule, subject to the provisions of the PIPEDA. Part 1 of the PIPEDA provides individuals with a right to privacy concerning their personal information. "Personal information" is broadly defined as "information about an identifiable person," but does not include the name, title, or business address or telephone number of an employee of an organization.[61] The basic principle at the core of this right to privacy is that personal information should not be collected, used, or disclosed, without the prior knowledge and consent of the individual concerned, subject to the limited exceptions in the PIPEDA.

The scope of the legislation is extraordinarily broad. Part 1 of the PIPEDA will eventually apply to every "organization" (defined to include an association, a partnership, a person—

58. Foreign Bank Tax Proposals (proposed Aug. 9, 2000), *available at* http://www.fin.gc.ca/newse00/00-059e.html.

59. Personal Information Protection and Electronic Documents Act, ch. 5, S.C. 2000 (Can.), *available at* http://www.parl.gc.ca/36/2/parlbus/chambus/house/bills/government/c-6/c-.../c-6_cover_E.html.

60. The ten privacy principles of the CSA Standard are Principle 1: Accountability; Principle 2: Identifying Purposes; Principle 3: Consent; Principle 4: Limiting Collection; Principle 5: Limiting Use, Disclosure and Retention; Principle 6: Accuracy; Principle 7: Safeguards; Principle 8: Openness; Principle 9: Individual Access; and Principle 10: Challenging Compliance. Model Code for the Prot. of Pers. Info. (Canadian Standards Assoc. 1996), *available at* http://ww.anu.edu.au/people/Roger.Clarke/DV/Can.Model.html.

61. Personal Information Protection and Electronic Documents Act, ch. 5, no. 2, S.C. 2000 (Can.), *available at* http://www.parl.gc.ca/36/2/parlbus/chambers/house/bills/government/c-6/c-.../c-6_cover_E.html.

which would include a corporation—or a trade union) concerning all personal information, which that organization collects, uses, or discloses in the course of a "commercial activity" (defined as any particular transaction, act, or conduct or any regular course of conduct that is of a commercial character, including the selling, bartering, or leasing of donor, membership, or other fundraising lists).[62]

There is no "grandfathering" provision exempting an organization from the application of the PIPEDA concerning the use or disclosure of information already in their possession. An organization is unable to use or disclose any personal information that it collected prior to the PIPEDA affecting it without the prior knowledge and consent of the individuals concerned, unless the organization now obtains consents from all of those individuals, or an exemption in the PIPEDA permits the use or disclosure of the information without consent. For many businesses, obtaining these consents will not be feasible or will be prohibitively expensive and, consequently, existing databases of personal information may be rendered useless.

The application of the PIPEDA takes place in three stages.

1. *First Stage: Application on Coming into Force*

Effective January 1, 2001, Part 1 applies to

(a) any organization that collects, uses or discloses personal information within a province in the course of commercial activities, including personal information about an employee of the organization in connection with the operation of a federal work, undertaking or business; and
(b) any other organization that collects, uses or discloses personal information within a province in the course of commercial activities, which the organization discloses outside the province (i.e., interprovincially and internationally) for consideration.

Canadian banks are expressly caught by the definition of "federal work, undertaking or business" and, therefore, must meet the personal information protection standards now.[63] Federally or provincially incorporated or regulated insurance companies, trust and loan companies, and securities dealers may also be required to comply with the PIPEDA on its proclamation if they collect, use, or disclose personal information within a province in the course of their commercial activities and disclose that information outside that province for consideration.

2. *Second Stage: Personal Health Information Affected One Year After Coming into Force*

Until January 1, 2002, Part 1 of the PIPEDA does not apply to any organization affected at the first stage of implementation with respect to personal health information that it collects, uses, or discloses. Personal health information is defined broadly to include, among other things, information about the physical or mental health of an individual, or health services provided to the individual, whether living or dead.

The Ontario government has recently introduced health information privacy legislation in its legislature that, if enacted, will establish specific rules for the collection, use, and disclosure of personal health information in that province.

62. *See id.*
63. *Id.*

3. *Third Stage: Application Three Years After Coming into Force*

Effective January 1, 2004, Part 1 of the PIPEDA applies to all organizations in Canada, including those businesses collecting, using, and disclosing personal information solely within a province.

Canadian provinces have jurisdiction over property and civil rights. Quebec has had private-sector privacy legislation in effect since 1993, and other provinces are considering the enactment of privacy legislation. Where a province enacts substantially similar legislation that applies to an organization, a class of organizations, an activity, or a class of activities, the federal Cabinet may, by order, exempt the organization, activity, or class from the application of this Part in respect of the collection, use, or disclosure of personal information that occurs within that province.

Since it is unclear what constitutes "substantially similar" legislation, provincial privacy legislation may create different requirements (e.g., consent criteria) and exemptions, raising compliance issues for interprovincial business activities. According to a federal government news release, Quebec's existing privacy law meets this "substantially similar" test, despite certain legislative differences.

Even if provincial privacy legislation affects a business, if the business collects, uses, or discloses personal information in the course of commercial activity in one province and discloses it in another province or outside Canada for consideration, it will remain subject to Part I of the PIPEDA in respect of those activities. Organizations that operate in several jurisdictions, therefore, face the prospect of compliance with different privacy laws that establish different standards and procedures.

The PIPEDA imposes obligations on organizations concerning the treatment of personal information. Personal information must be collected for identified purposes only and, in most cases, consent will be required to collect, use, or disclose personal information. In addition, the PIPEDA imposes administrative obligations on organizations; they must be accountable for the information in their possession or control, must maintain the accuracy of information, provide adequate safeguards, and adopt guidelines for the retention and destruction of information. Organizations must have procedures to handle inquiries and complaints.

The PIPEDA is enforced by the federal Privacy Commissioner, who has the authority to investigate complaints, conduct audits, and publicize an organization's privacy practices. A court may impose fines on persons who are guilty of offences under the PIPEDA, and may order an organization to correct its practices. In addition, a court may order damages, including damages for humiliation and punitive damages, to be paid.

D. New Money Laundering Legislation

In June 2000, Canada's Parliament enacted the Proceeds of Crime (Money Laundering) Act[64] (the "Act"), which, when proclaimed in force, will replace existing legislation by the same name. The Act's main objectives include implementing measures for the prevention of money laundering, and the investigation and prosecution of money laundering offences. The Act was passed as part of Canada's international commitment to fight money-laundering activities.

64. Proceeds of Crime (Money Laundering) Act, ch. 17, S.C. 2000 (Can.), *available at* http://www.canada.justice.gc.ca/en/laws/P-24.501/83310.html.

The Act is expected to come into force in 2001 along with regulations that will detail new reporting and record-keeping requirements. The regulations will expand considerably the range of institutions affected by the legislation. Significant monetary and penal sanctions will be imposed on those who knowingly contravene the Act and regulations.

The Act establishes the Financial Transactions and Reports Analysis Center of Canada (FINTRAC), an independent agency that will receive and analyze information reported under the Act and regulations. FINTRAC has the authority to investigate the business and affairs of entities to which the Act applies. FINTRAC's broad powers include the authority to investigate the premises and computer systems of an entity and to copy and remove documents from the premises if required.

The legislation requires financial institutions, real estate brokers and agents, lawyers, accountants and others to report and keep records of certain transactions conducted by clients on their own behalf or on behalf of third parties. The record-keeping requirements are more onerous under the new Act. Records must be retained in a manner that permits an authorized examiner under the Act to examine the record within thirty days of the examiner's request.

The Act stipulates that where a person or entity has reasonable grounds to believe that a financial transaction may involve a money-laundering offence, the person or entity must report it to FINTRAC within thirty days of the suspicion arising. FINTRAC has established guidelines to assist in detecting a suspicious transaction.

The Act requires that entities implement a compliance regime to meet the new obligations imposed by the Act. Entities are required to develop policies and procedures for compliance with the Act and to designate an individual who will be responsible for implementing the compliance regime. The Act further mandates the implementation of an ongoing employee training program so that employees have a basic understanding of what money laundering is, how it usually occurs and what the legislation's reporting and record-keeping requirements are.

IV. European Union

There have been four major developments in the international financial services area in the year 2000: (a) the adoption of the E-Commerce Directive by the European Union (EU); (b) data protection and safe harbor developments; (c) the amendment of the proposed Distance Marketing of Consumer Financial Services Directive; and (d) the proposal of a Pension Funds Directive.

A. Electronic Commerce Directive (Directive 2000/31/EC)[65]

To facilitate electronic contracting across the EU, the E-Commerce Directive (Directive) provides a series of general, basic protections for Internet transactions and aims to eliminate legislative obstacles at the member state level. This Directive covers any service normally provided for remuneration, at a distance, by means of electronic equipment for the processing (including digital compression) and storage of data, and at the individual request of a recipient of a service. The online offer of financial services and products (including private

65. Parliament and Council Directive 00/31, 2000 O.J. (L 178).

equity funds) is subject to the Directive because they typically include an individual requesting distance data processing services for payment. The Directive, together with the Distance Marketing Directive, will contribute to the creation of a legal framework for the online provision of financial services and products.

The Directive requires Member States to ensure that: (a) the service provider makes certain information easily accessible to the recipients of the service and to applicable authorities; (b) where a fee for services is charged, the fee is clearly described and any additional tax and delivery costs are separately identified; and (c) their legal system allows contracts to be concluded by electronic means.[66] In particular, Member States must ensure that the legal requirements applicable to the contractual process do not impede the use of electronic contracts or result in such contracts being deprived of legal effectiveness and validity on account of their having been made by electronic means.

The Directive requires Member States to ensure that prior to the placement of the order the service provider gives a person wishing to place an order at least a certain minimum amount of information. This requirement does not apply to contracts concluded exclusively by exchange of electronic mail or by equivalent individual communications.

The Directive places certain limits on unsolicited commercial communications. Member States may permit unsolicited commercial communication by electronic mail. In this case, however, Member States must ensure that commercial communications from a service provider in their territory be clearly and unambiguously identifiable as commercial communications as soon as the recipient receives them. Moreover, Member States are required to take measures to ensure that service providers sending unsolicited commercial communications by electronic mail refrain from sending communications to natural persons who have registered in the "opt-out" register maintained by the member state. Service providers must consult these registers regularly.

The Directive imposes certain requirements on Member States to facilitate out-of-court dispute settlement. They also must ensure that court actions available under national law allow for the rapid adoption of interim and final measures aimed at terminating alleged infringements and preventing further prejudice to the interests involved.

Member States must bring their laws, regulations, and administrative provisions into compliance with this Directive by January 17, 2002.

B. Data Protection and Safe Harbor Developments

The EU Directive (95/46/EC)[67] on data protection provides that data cannot be exported outside of the EU to a country that does not provide an "adequate" level of privacy protection. The EU Commission originally determined that the United States, which has an approach to privacy protection based on a mix of legislation, regulation, and self-regulation, did not satisfy this requirement. The EU Commission and U.S. Department of Commerce started negotiations to resolve this issue.

On July 27, 2000, the EU Commission approved a set of principles, the Safe Harbor Principles[68] (Safe Harbor), which create a Safe Harbor for U.S. companies that choose voluntarily to adhere to the privacy guidelines set forth therein. These Principles are de-

66. *See id.* ch. 2, § 3, art. 9(1).

67. Parliament and Council Directive 95/46, 1995 O.J. (L 281).

68. (EU Commission citation), *see also* U.S.-EU Safe Harbor Privacy Principles and FAQ, 65 Fed. Reg. 45,666.

tailed in a short document and in the annexed Frequently Asked Questions. U.S. companies certified under the Safe Harbor are in compliance with the EU Privacy Directive as they are deemed to provide "adequate" privacy protection, as defined by the Directive. The Safe Harbor is a voluntary system and applies only to the export of data from the EU to the United States. To be in compliance with the Safe Harbor, an organization must develop self-regulatory privacy policies that conform to the Principles.

The seven principles of the Safe Harbor are: (a) Notice (an organization must inform individuals about the purposes for which it collects information about them); (b) Choice (i.e., "opt-out" for disclosure of data and "opt-in" for disclosure of sensitive information); (c) Onward Transfer (an organization must provide an individual with notice and choice before it can transfer information to a third party); (d) Security ("reasonable precautions" must be taken to protect data from loss); (e) Data Integrity (personal information kept must be "relevant" for the purposes for which it is to be used); (f) Access (individuals must have access to personal information); and (g) Enforcement (mechanisms for assuring compliance with the Principles).

Financial institutions are not covered by the Safe Harbor Principles. Privacy protections for consumers and customers of financial institutions are granted by the Gramm-Leach-Bliley Act (GLBA),[69] which was signed into law in November 1999.

The three key privacy provisions of the GLBA are: (a) Notice (financial institutions must provide customers with notices describing their privacy policies); (b) Opt-Out (financial institutions may not disclose personal information to any non-affiliated third party unless consumers are given an opportunity to opt-out); and (c) Marketing (prohibition on disclosing data to a non-affiliated third party for marketing purposes).[70] Financial institutions have until July 2001 to come into compliance with the GLBA.

Negotiations on the GLBA and the Safe Harbor were taking place contemporaneously, and the U.S. negotiators suggested that any financial institution in compliance with the GLBA would also be providing "adequate" protection of data under the Safe Harbor. However, the EU disagreed for two primary reasons: (a) there is no total opt-out provision, therefore, consumers can only opt-out of having their information shared with non-affiliated parties, and (b) there is no specific provision requiring financial institutions to give consumers access to their information.

C. Amended Distance Marketing of Consumer Financial Services Directive

In addition to the E-Commerce Directive, the European Commission is also preparing the Distance Marketing Directive.[71] The definition of financial services covered by this Directive is quite broad and includes "any service of a banking, credit, insurance, personal pension, investment or payment nature."[72] Indeed, the Distance Marketing Directive would cover the offering of mutual funds via the Internet in Europe.[73] The Distance Marketing

69. Gramm-Leach-Bliley Act, *supra* note 1.

70. *See id.* tit. 5, § 502.

71. *See* Amended Proposal for a European Parliament and Council Directive Concerning the Distance Marketing of Consumer Financial Services and Amending Directives 97/7/EC and 98/27/EC, COM(99)305 final [hereinafter Distance Marketing Directive Proposal].

72. *Id.* art. 2(b).

73. Distance Marketing Directive Proposal, *supra* note 71, art. 4(1).

Directive is designed to provide certain specific guarantees to consumers deemed appropriate and necessary for the offering via the Internet of these services.

At present, the amended form of the Distance Marketing Directive is being discussed at the Council level. The major sticking point has been the Commission's proposed maximum harmonization approach. Other financial services directives have been implemented on the basis of minimal harmonization. Particular concern existed regarding the impact of the Proposed Directive's prior information requirements on the existing requirements in other financial services directives already implemented on the basis of minimum harmonization. To understand the extent of potential conflicts, the Commission undertook a survey of national level information requirements. More than 1,400 pages of answers to the questionnaires were received. The Commission presented a report to the Consumer Working Group on July 26, 2000 and negotiations resumed in September 2000. The draft Directive was discussed (very briefly) during the Internal Market Council on November 30, 2000. Discussions are likely to resume in mid-January, following the forthcoming Communication on E-Commerce and Financial Services due early next year.

Article 3 of the Amended Distance Marketing Directive provides that before the conclusion of the contract on paper or another durable medium, consumers shall be provided, among other things, specific information describing the characteristics of the financial service in question and the following information: (a) the identity of the supplier; (b) when the consumer's dealings are with any professional other than the supplier, the identity of this professional and the geographical address relevant for the customer's relations with this professional; (c) the total price to be paid by the consumer, (d) notice of the possibility that other taxes or costs may exist; (e) the arrangements for payment and for performance; (f) any specific additional cost of using the means of distance communication; (g) the existence or absence of a right of withdrawal; (h) the minimum duration of the contract; (i) information on cancelling the contract; and (j) practical instructions for exercising the right of withdrawal.

The Amended Distance Marketing Directive also provides that, in implementing the Directive, Member States shall give consumers a right of withdrawal of fourteen to thirty days, depending on the nature of the financial services concerned, without having to indicate grounds and without penalty. Sources at the Commission have informed us that this provision has been modified in the current draft of the Directive so that, as a general rule, the consumer has a fourteen-day right of withdrawal. Member States, however, may provide for a thirty-day withdrawal period for insurance and personal pension services.

As a general rule, the protections of this Directive cannot be waived by the consumer. Even where the contract is governed by the law of a third country, the consumer shall still have the rights set forth in the Directive provided that he resides in a member state and the contract has a close link with the community.

D. Proposed Pension Fund Directive

On October 11, 2000, the EU Commission presented a proposal for a Directive on the coordination of laws concerning Institutions for Occupational Retirement Provision (IORP),[74] being a financial institution that: (a) receives contributions paid by employers and

74. Proposal for a Directive of the European Parliament and of the Council on the Activities of Institutions for Occupational Retirement Provision, COM(00)507 final.

employees in the context of a saving scheme, (b) invests these contributions, and (c) pays out the retirement benefits.[75] Since contributions paid to an IORP generally cannot be withdrawn before the age of retirement,[76] IORPs are allowed to invest in non-liquid assets such as shares, including shares issued by small corporations.[77] For these reasons, IORP play a key role in (a) increasing the social protection standards, (b) financing the EU economy, and (c) realizing the efficient allocation of savings in the EU.

The proposed Directive seeks to harmonize basic prudential rules and to establish mutual recognition of national prudential systems under the Home Country Control Principle. Thus, a legal framework of European prudential standards will be created. These standards will establish a system of notification and cooperation between competent authorities that allows IORP, duly authorized and supervised in their own member state, to provide cross-border services within the single market of financial transactions.[78] However, precise arrangements for the payment of benefits (which are often dependent on national tax, labor, and social law) may be decided inside the Member States.[79]

To safeguard the assets of IORP for the members and beneficiaries, in case of bankruptcy of the sponsoring undertaking (any undertaking or other body that pays contributions into an institution),[80] the proposed Directive provides legal separation between the sponsoring undertaking and the IORP.[81] Moreover, Member States shall require that institutions located in their territory draw up annual accounts and an annual report, giving "a true and fair view of the institution's assets, liabilities and financial position."[82] Member States shall ensure that every three years, as well as without delay after any significant change in the investment policy, all institutions located in their territories disclose their investment policies to the competent authority of the home member state.[83] The relevant member state shall ensure that the competent authority has the necessary power: "(a) to require the institution . . . to supply information about all business matters or forward all business documents; (b) to supervise contracts regulating relationships between the institution and other companies . . . ; and (c) to obtain regularly, all the documents necessary for the purposes of supervision."[84]

V. India

A. Derivative Trading

Effective June 1, 2000, the Government of India enacted the Foreign Exchange Management Act, 1999 (FEMA),[85] which replaces the existing Foreign Exchange Regulation

75. *See id.* art. 6(a).
76. *See id.* art. 6(d).
77. *See id.* art. 18(6).
78. *See id.* art. 20.
79. *See id.* art. 18.
80. *Id.* art. 6(c).
81. *Id.* art. 8.
82. *Id.* art. 10.
83. *Id.* art. 12(1).
84. *Id.* art. 13.
85. Foreign Exchange Management Act of 1999, Act No. 42 (India), *available at* http://www.indialawinfo.com/bareacts/fema.html.

Act, 1973 (FERA).[86] Along with the FEMA, various regulations were also notified with respect to aspects of foreign exchange transmission. These aspects included current and capital account payments, loans, and guarantees in foreign exchange, derivates, and investment in and outside of India. The FEMA provisions relating to derivatives are discussed below.

Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations of 2000[87] provides that "[a] person resident in India may enter into a foreign exchange derivative contract in accordance with the provisions . . . to hedge an exposure" to exchange risk with respect to a permissible transaction.[88]

> A person resident in India may enter into a forward contract with an authorised dealer[89] in India to hedge an exposure to exchange risk in respect of a transaction for which sale and/or purchase of foreign exchange is permitted under the Act, or rules or regulations . . . , subject to the following conditions:
>
> (a) the authorised dealer through verification of documentary evidence is satisfied about the genuineness of the underlying exposure,
> (b) the maturity of the hedge does not exceed the maturity of the underlying transaction,
> (c) the currency of hedge and tenor are left to the choice of the customer,
> (d) where the exact amount of the underlying transaction is not ascertainable, the contract is booked on the basis of a reasonable estimate,
> (e) foreign currency loans/bonds will be eligible for hedge only after final approval is accorded by the Reserve Bank where such approval is necessary,
> (f) in case of Global Depository Receipts (GDRs) the issue price has been finalized,
> (g) balances in the Exchange Earner's Foreign Currency (EEFC) accounts sold forward by the account holders shall remain earmarked for delivery and such contracts shall not be cancelled. They may be, however, be [sic] rolled-over,
> (h) contracts involving rupee as one of the currencies, once cancelled shall not be rebooked although they can be rolled over at ongoing rates on or before maturity. This restriction shall not apply to contracts covering export transactions which may be cancelled, rebooked or rolled-over at on-going rates, and
> (i) substitution of contracts for hedging trade transactions may be permitted by an authorised dealer on being satisfied with the circumstances under which such substitution has become necessary.[90]

A person resident in India who has borrowed exchange under the FEMA regulations may enter into an interest rate swap, currency swap, coupon swap, foreign currency option, interest rate cap or collar (for purchases), or forward rate agreement contract with an authorized dealer in India or with a branch of an authorized dealer outside India, to hedge his loan exposure and unwind from such hedges, provided that

1. the contract does not involve rupee,
2. the Reserve Bank has accorded final approval for borrowing in foreign currency,

86. Foreign Exchange Regulation Act of 1973, Act No. 46 (India), *available at* http://www.premisesindia.com/fera-act.htm.

87. Foreign Exchange Management Regulations of 2000, FEMA/1/RB-2000-25/RB-2000 (India), *available at* http://www.rbi.org.in [hereinafter Derivative Regulations].

88. *Id.* ¶ 4.

89. An authorized dealer means a person who has been authorized by the Reserve Bank of India to deal in foreign exchange.

90. Derivative Regulations, *supra* note 87, Sched. 1(A)(1).

3. the notional principal amount of the hedge does not exceed the outstanding amount of the foreign currency loan, and
4. the maturity of the hedge does not exceed the unexpired maturity of the underlying loan.[91]

"A person resident in India, who owes a foreign exchange or rupee liability, may enter into a contract for foreign currency-rupee swap with an authorised dealer in India to hedge long term exposure."[92] Such contract, however, if cancelled, shall not be rebooked or re-entered.[93]

> A person resident in India may enter into a foreign currency option contract with an authorised dealer in India to hedge foreign exchange exposure of such person arising out of his trade, [p]rovided that in respect of cost effective risk reduction strategies like range forwards, ratio-range forwards or any other variable by whatever name called there shall not be any net inflow of premium.[94]

The Regulations also permit a person resident outside India to enter into foreign exchange derivative contracts with a person resident in India to hedge foreign exchange exposure with respect to specified transactions:

> A Registered Foreign Institutional Investor (FII) may enter into a forward contract with rupee as one of the currencies with an authorised dealer in India to hedge its exposure in India, [p]rovided that:
> (a) the value of the hedge does not exceed the current market value in respect of investments in debt instruments,
> (b) the value of the hedge does not exceed 15% of the market value of the equity as at the close of business on 31st March 1999, converted at the rate of US \$ 1 = Rs. 42.43 plus the increase in market value/inflows after 31st March 1999 provided that the forward cover once taken shall be allowed to continue as long as it does not exceed the value of the underlying investment,
> (c) forward contracts once cancelled shall not be rebooked but may be rolled over on or before the maturity,
> (d) the cost of hedge is met out of repatriable funds and/or inward remittance through normal banking channel,
> (e) all outward remittances incidental to hedge are net of applicable Indian taxes.[95]

> A non-resident Indian or Overseas Corporate Body may enter into forward contract with rupee as one of the currencies, with an authorised dealer in India to hedge:
> (a) the amount of dividend due to him/it on shares held in an Indian company,
> (b) the balances held in Foreign Currency Non-Resident (FCNR) account or NonResident External Rupee (NRE) account,
> (c) the amount of investment made under portfolio scheme in accordance with the provisions of the Foreign Exchange Regulation Act, 1973 or under notifications issued thereunder or is made in accordance with the provisions of the Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000 and in both cases subject to the terms and conditions specified . . .[96]

91. *Id.* Sched. 1(B)(2)(1).
92. *Id.* Sched. 1(2)(2).
93. *See id.* Sched. 1(2)(3).
94. *Id.* Sched. 1(3)(1).
95. *Id.* Sched. 2(1).
96. *Id.* Sched. 2(2).

B. Information Technology Act

India has enacted the Information Technology Act, 2000 (IT Act),[97] which is largely based on the Model Law on Electronic Commerce adopted by the United Nations (U.N.) in 1997.[98] India is now among the few countries to have e-commerce laws. India's law envisages legalization of electronic signatures on the Internet, sanctification of credit card transactions, and a boost in e-commerce.[99] The IT Act also amends various other laws such as the evidence and banking regulation acts. The IT Act is not applicable to negotiable instruments, powers of attorney, trusts, wills, contracts for sale of immovable property, or other transactions or documents that may be notified by the Central Government.[100]

Under the IT Act,

> where any law provides that information or any other matter shall be in writing or in typewritten or printed form, then . . . such requirement shall be deemed to have been satisfied if such information or matter is (a) rendered or made available in electronic form; and (b) accessible so as to be usable for a subsequent reference.[101]

The term '"electronic form" with reference to information means any information generated, sent, received, or stored in media, magnetic, optical, computer memory, microfilm, computer generated microfiche or similar device."[102]

Similarly, "[w]here any law provides that information or matter shall be [signed,] such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by . . . digital signature affixed in such manner as may be prescribed by the Central Government."[103]

The term "digital signature" has been defined to mean authentication of an electronic record by a person in whose name the digital signature issued by means of any electrical method.[104] "The authentication of the electronic record shall be effected by use of asymmetric crypto system and hash function, which envelop and transfer the initial electronic record to another electronic record."[105] Any person can verify the electronic record using the subscriber's public key.[106]

Affixing a digital signature requires (a) performing a hash function on the message to be signed, (b) encrypting the result of that hash function with signer's private key, and (c) appending the resulting signature to the message.[107] Verification of a digital signature requires (a) decrypting the signature using a signer's private key, (b) running the same hash function on the message received, and (c) comparing the above two results of the first step and the second step.[108] The signature is verified if the results match. "The private key and

97. The Information Technology Act of 2000, No. 21 (India), *available at* http://www.focustamilnadu.com/India/information_technology_act.htm [hereinafter IT Act].

98. G.A. Res., U.N. GAOR, 51st Sess., 85th plen. mtg., U.N. Doc. A/RES/51/162 (1996).

99. *See* IT Act, *supra* note 97.

100. *See id.* ch. 1(1)(4).

101. *Id.* ch. 3(4).

102. *Id.* ch. 1(2)(1)(v).

103. *Id.* ch. 3(5).

104. *See id.* ch. 1(2)(1)(p).

105. *Id.* ch. 2(3)(2).

106. *See id.* ch. 2(3)(3).

107. *See generally id.* ch. 2(3).

108. *See generally id.* ch. 1(2)(1)(2h).

public key are unique to the subscriber and constitute a functioning key pair."[109] The process of creating and verifying digital signatures accomplishes the essential effects described for many legal purposes. It can be used, like a hand-written signature, as proof of an agreement.

The IT Act has amended the provisions of the Bankers' Books Evidence Act in the following manner:

1. The term "bankers' books" has been defined to include "ledgers, day-books, cash-books, account-books and all other books used in the ordinary business of a bank whether kept in the written form or as printouts of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device";
2. The term "certified copy" has been defined as follows: when a bank's books—

   (a) are maintained in written form, a copy of any entry in such books together with a certificate written [at] the foot of such copy that it is a true copy of such entry, that such entry is contained in one of the ordinary books of the bank and was made in the usual and ordinary course of business and that such book is still in the custody of the bank, and where the copy was obtained by a mechanical or other process which in itself ensured the accuracy of the copy, a further certificate to that effect, but where the book from which such copy was prepared has been destroyed in the usual course of the bank's business after the date on which the copy had been so prepared, a further certificate to that effect, each such certificate being dated and subscribed by the principal accountant or manager of the bank with his name and official title; and

   (b) consist of printouts of data stored in a floppy, disc, tape or any other electro-magnetic data storage device, a printout of such entry or a copy of such printout together with such statements certified in accordance with the provisions of Section 2A.[110]

The said Act also recognizes transfer of funds through electronic means between banks and financial institutions.[111] The Reserve Bank of India Act, 1934, has been amended so that the RBI is allowed to regulate the transfer of funds through electronic means.[112]

109. *Id.*
110. *Id.* Sched. 3(1)(b).
111. *See id.* Sched. 4.
112. *See id.*