

October 29, 2015

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Dear Ms. Wood and Ms. Cole:

Re: ***Financial Institutions Act & Credit Union Incorporation Act Review***

This letter is the Commission's response to the June 2015 initial public consultation paper related to the *Financial Institutions Act (FIA) & Credit Union Incorporation Act (CUIA)* review.\* Reference in this consultation response to FICOM includes the Commission, the Superintendent and staff. The Commission, Superintendent and staff individually will be referenced as such.

While the consultation paper raises numerous important issues that merit thoughtful discussion, we have chosen to not cover all topics. This response focuses on the powers and resources necessary for FICOM to effectively discharge its mandate in a manner that reflects best practices in prudential supervision.

We would be pleased to elaborate on our recommendations and would appreciate the opportunity to meet with Ministry staff to discuss them further. If you wish our input on an issue for which we have omitted providing a response, we would be pleased to provide our views. Please note that these submissions may be made public.

Yours truly,



Helen R. del Val, Chair

\*The ex-officio member of the Commission, who is the Deputy Minister of Finance or her designate, elected not to participate in this submission, given her direct association with the Ministry that launched the consultation. The remaining Commission members have no ties to government or to any of the regulated institutions. This submission was completed independent of the Superintendent and staff.

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## **SUMMARY OF RECOMMENDATIONS**

### **The Commission recommends that:**

**R-1:** The FIA explicitly include a stated purpose of the Act.

**R-2:** The FIA set forth the objectives of FICOM. These should include promotion of safety and soundness of financial institutions; protection of the public from undue loss and unfair market conduct; and, timely intervention to deal with issues before they threaten the stability of the province's financial system.

**R-3:** The FIA re-constitute FICOM as structurally separate and arm's-length of government with authority to set operating and human resource policies that allow it to carry out its mandate.

**R-4:** The FIA set out the Commission and Superintendent's respective mandates to clarify that the:

- i. Commission provides oversight to the Superintendent including decisions related to direction of the organization such as those related to budget, operations and human resources planning;
- ii. Commission acts as a specialized administrative tribunal, adjudicating matters based upon the factual record created by the Superintendent and staff;
- iii. Commission approves supervisory policies and procedures;
- iv. Superintendent is vested with direct responsibility and the appropriate tools to administer day-to-day prudential supervision.

**R-5:** Commission members be independent of both government and supervised institutions.

**R-6:** The FIA require regular meetings between the Commission Chair and the Minister to facilitate open communication and understanding of government policy and regulatory matters where they intersect.

**R-7:** The FIA delineate the Commission's authority to issue guidelines after conducting mandatory public consultation on draft guidelines and following due process.

**R-8:** FICOM be provided with additional well-tailored, proportionate tools and the ability to hire and retain sufficient expert staff to exercise its powers fairly and appropriately and in a timely manner.

**R-9:** The FIA incorporate the best supervisory practice of extending privilege to certain supervisory information.

**R-10:** The FIA require effective risk management of financial institutions including a committee of an institution's board to oversee all risks in the institution as set out in guidelines issued by the Commission.

**R-11:** The FIA require that financial institutions hold adequate and appropriate forms of capital and liquidity as set out in guidelines issued by the Commission.

**R-12:** The FIA delineate the Commission's authority to designate institutions as systemically important. Once designated, these institutions may be subject to additional prudential requirements necessary to mitigate systemic risk including the preparation of recovery and resolution plans, as set out in guidelines issued by the Commission.

**R-13:** The FIA establish an effective resolution regime that addresses the following areas:

- i. The Commission determine when a financial institution is no longer viable and should be resolved;
- ii. FICOM be designated as the resolution authority for British Columbia;
- iii. The FIA provide the necessary authority to ensure sufficient liquidity in a crisis, including Emergency Lending Assistance from the Bank of Canada.

**R-14:** The FIA provide that a central credit union be subject to the same prudential standards and guidelines as all other credit unions in the province of British Columbia and any additional measures that apply to institutions designated as systemically important.

**R-15:** The FIA provide FICOM with the authority to approve, reject and impose prudential conditions on all major transactions (i.e. acquisitions, divestitures or investments) by a financial institution.

**R-16:** An ombudsperson for financial institutions be designated to provide a mandatory alternate dispute resolution mechanism for members and customers who are dissatisfied with a retail service or product provided.

**R-17:** The FIA authorize the Commission to require credit unions to adopt disclosure and voting practices that will engage members, provide them with adequate information and encourage the exercise of voting rights, as set out in guidelines issued by the Commission.

**R-18:** The government review unlimited deposit insurance and, as soon as circumstances permit, move to limit such coverage with careful planning of the transition.

**Financial Institutions Act  
and Credit Union Incorporation Act Review**

**Commission Response to the Initial Public Consultation Paper**

**INTRODUCTION**

The Commission<sup>1</sup> has prepared this response to the Ministry of Finance's June 2015 consultation paper for several reasons. First, we wish to offer our experience and perspective as the regulator that has worked under the current regime and followed closely the evolution of international best practices in the exercise of prudential and market conduct supervision of the financial sector. Second, we wish to draw attention to parts of the current framework that no longer work effectively. Third, we wish to provide a voice for the broader public we serve, who are less likely to respond to this consultation. This response has been prepared taking into account FICOM's mandate to safeguard confidence and stability in British Columbia's financial sector by protecting consumers from undue loss and unfair market conduct.<sup>2</sup> It focuses on the powers and resources necessary for FICOM to effectively discharge its mandate in a manner that reflects best practices in prudential supervision.

**BACKGROUND**

Since the last financial institutions legislative review conducted over a decade ago, regulatory and supervisory approaches globally have changed significantly. Furthermore, the financial crisis has heightened the public's concern that its savings are secure and that governments and regulators act to keep the financial system operating even through the worst crises. As the intermediary between savings and investment, the financial system performs a unique function in the economy. There is a clear expectation that governments and regulators manage risk effectively to ensure that financial stability is maintained -- a critical public interest consideration. Achieving financial sector stability justifies not only public regulation but also a

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<sup>1</sup> The ex-officio member of the Commission, who is the deputy minister of finance or her designate, elected not to participate in this submission, given her direct association with the Ministry that launched the consultation. The remaining Commission members have no ties to government or to any of the regulated institutions. Reference in this consultation response to FICOM includes the Commission, the Superintendent and staff. The Commission, Superintendent and staff individually will be referenced as such.

<sup>2</sup> [http://www.fic.gov.bc.ca/?p=about\\_us/mandate](http://www.fic.gov.bc.ca/?p=about_us/mandate)

more proactive role for supervision than in other sectors, where regulation typically is aimed only at ensuring that rules are followed.<sup>3</sup>

Like most other financial services regulators in the world, FICOM has adopted a principles-based framework for financial institutions supervision. Within such a framework, the focus of FICOM's supervisory work is based on its assessment of risk. Its job is to determine the potential impact of current and future events, and to respond early to lessen significant risks to the individual financial institutions, to the financial system as a whole and to the public. FICOM strives to make its risk-based supervision as dynamic and forward-looking as possible to respond effectively to changes in British Columbia's financial system, now and in the future.

We believe that British Columbia's legislative framework for financial institutions should be grounded in leading practices for prudential supervision. These are articulated in the Core Principles for Effective Banking Supervision (Core Principles), which are the de facto global minimum standard for sound prudential regulation and supervision.<sup>4</sup> Originally issued by the Basel Committee on Banking Supervision in 1997 and updated in 2012, the Core Principles are used as a benchmark for assessing the quality of supervisory systems and for identifying future work to assure sound supervisory practices.<sup>5</sup> The International Monetary Fund (IMF) and the World Bank also use the Core Principles to assess the effectiveness of countries' financial sector supervisory systems and practices through their Financial Sector Assessment Program (FSAP). Both federal and provincial supervision of the financial system is regularly scrutinized under this FSAP program. The Core Principles for Banking Supervision were developed for banks; however, with few exceptions and very minor modifications, their focus on protecting depositors means they also apply to the credit union supervisory framework in British Columbia.

As global leading practices for supervision evolves, so too must the legislative framework on which supervisory authority is based. Accordingly, we seek a modernized structure for FICOM and a principles-based legislative framework that will support risk-based supervision and continued access by British Columbians to financial services, even through a financial crisis.<sup>6</sup>

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<sup>3</sup> IMF Working Paper, WP/02/46 – Regulatory and Supervisory Independence and Financial Stability, Marc Quintyn and Michael W. Taylor.

<sup>4</sup> The Basel Core Principles can be found at: <http://www.bis.org/publ/bcbs230.htm>. The International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems as well as the International Association of Insurance Supervisors Core Principles should also be adhered to.

<sup>5</sup> The Basel Committee on Banking Supervision currently consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

<sup>6</sup> The Commission currently provides oversight and direction to the Superintendent, who is appointed by the Lieutenant Governor in Council. The Commission can delegate certain powers to the Superintendent, but must then oversee the use of that delegation. The Commission has no staff as day-to-day regulatory and operational decisions are administered by the Superintendent and her staff of about 90 people hired under the *Public Service Act*, [RSBC 1996] Chapter 385. The Superintendent, who is also the chief executive officer of FICOM, serves in several official capacities, including Superintendent of Financial Institutions, Superintendent of Pensions, Superintendent of Real

## **OVERALL FRAMEWORK ISSUES**

### *Purpose & Objectives*

**R-1: The FIA explicitly include a stated purpose of the Act.**

**R-2: The FIA set forth the objectives of FICOM. These should include promotion of safety and soundness of financial institutions; protection of the public from undue loss and unfair market conduct; and, timely intervention to deal with issues before they threaten the stability of the province's financial system.**

Modern legislation should use plain language to set out clearly its purposes and objectives and to define the roles and responsibilities of the various actors within that legislative framework. As the Core Principles are the *de facto* minimum standard for sound prudential regulation and supervision, we recommend that the legislative framework in British Columbia align with those principles. Core Principle 1 provides as follows:

#### ***Principle 1- Responsibilities, objectives and powers:***

*An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorise banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.*

#### ***Essential criteria:***

- 1. The responsibilities and objectives of each of the authorities involved in banking supervision are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.*
- 2. The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.<sup>7</sup>*

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Estate, Registrar of Mortgage Brokers and CEO of the Credit Union Deposit Insurance Corporation (CUDIC) under the corresponding legislation.

<sup>7</sup> *Supra*, note 4.

Consistent with this Principle, we recommend that the FIA explicitly include a stated purpose of the Act and set forth the objectives of FICOM. The federal *Office of the Superintendent of Financial Institutions Act* provides an example of legislative objectives for a prudential regulator.<sup>8</sup> The 2015 British Columbia *Chartered Professional Accountants Act* is an example of British Columbia legislation that sets forth objectives for the self-regulatory body for Chartered Professional Accountants in the province.<sup>9</sup> Entrenching clear objectives in legislation for FICOM would promote transparency and clarity and underpin a principles-based framework for the regulation of financial institutions in British Columbia.

FICOM's paramount objectives should include the promotion of safety and soundness of financial institutions, protection of the public from undue loss and unfair market conduct and timely intervention to deal with issues before they threaten the stability of British Columbia's financial system.

#### Governance and Accountability

**R-3: The FIA re-constitute FICOM as structurally separate and arm's-length of government with authority to set operating and human resource policies that allow it to carry out its mandate.**

**R-4: The FIA set out the Commission and Superintendent's respective mandates to clarify that the:**

- iv. **Commission provides oversight to the Superintendent including decisions related to direction of the organization such as those related to budget, operations and human resources planning;**
- v. **Commission acts as a specialized administrative tribunal, adjudicating matters based upon the factual record created by the Superintendent and staff;**
- vi. **Commission approves supervisory policies and procedures;**
- vii. **Superintendent is vested with direct responsibility and the appropriate tools to administer day-to-day prudential supervision.**

**R-5: Commission members be independent of both government and supervised institutions.**

**R-6: The FIA require regular meetings between the Commission Chair and the Minister to facilitate open communication and understanding of government policy and regulatory matters where they intersect.**

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<sup>8</sup> R.S.C., 1985, c. 18 (3rd Supp).

<sup>9</sup> [SBC 2015] Chapter 1.



The Core Principles provide significant guidance related to the independence, accountability and governance of supervisors. Core Principle 2 provides as follows:

***Principle 2 – Independence, accountability, resourcing and legal protection for supervisors:***

*The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.*

***Essential Criterion:***

*1. The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.<sup>10</sup>*

The IMF working paper “Regulatory and Supervisory Independence and Financial Stability” (referenced above, Note 3) advocates for a substantial degree of independence of regulators and supervisors both from government and industry. Such independence is necessary for regulators and supervisors to fulfill their mandate and preserve financial sector stability. At the same time, the authors, Quintyn and Taylor, urge the implementation of measures to hold independent regulators accountable, emphasizing that “agency independence and accountability need to go hand in hand.”<sup>11</sup> They explain the four dimensions of independence – regulatory, supervisory, institutional and budgetary. While the regulatory and supervisory dimensions are the core elements, institutional and budgetary independence are essential to support the execution of the core functions; without solid arrangements underpinning institutional and budgetary independence, regulatory and supervisory independence cannot be achieved. The authors recognize that the power of independence must be kept in check and point to the “often-cited danger of regulatory independence” being “over-zealous regulators” over-regulating the market and ignoring the cost of regulation. Transparent rule-making combined with mechanisms for consultation with all parties involved is one among several ways to address this concern.<sup>12</sup>

Separately accountable regulatory agencies are increasingly seen as a necessary component of modern governance. Arm’s-length regulatory agencies offer clear benefits to both the regulatory body and government ministry. For example, market interventions such as taking corrective

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<sup>10</sup> *Supra*, Note 4.

<sup>11</sup> *Supra*, Note 3, p. 1.

<sup>12</sup> *Supra*, Note 3, p. 3.

actions against a particular supervised institution are shielded from real or perceived political interference. Additionally, an independent regulatory and supervisory process offers improved transparency, stability and expertise.<sup>13</sup> As such, we recommend that FICOM be structurally separate and arm's-length of government.

An arm's-length arrangement could be achieved in a variety of ways as long as it operates within a defined public policy context that assures fairness and due process. The chosen arrangement, whatever it is, must include proper accountability mechanisms to balance the operational advantages of independence. Accordingly, we recommend that the mandates of the Commission and the Superintendent be repositioned and clarified along the following lines.

First, the Commission provides oversight to the Superintendent and staff. This would include making decisions on the direction of the organization such as those involving budget and human resources planning.

Second, the Commission continues to act as a specialized administrative tribunal, adjudicating matters based on the factual record created by the Superintendent and staff.

Third, the Commission approves policies and procedures for the supervision of financial institutions, such as guidelines discussed in recommendations 7, 11, 12, 14 and 17 below.

Fourth, the Superintendent has direct responsibility and the appropriate tools to administer day-to-day prudential supervision.<sup>14</sup>

The Basel Core Principles have made clear that independent regulation of financial institutions is a vital ingredient of financial stability. To avoid the potential for real or perceived conflicts of interest, all Commission members should be independent of the institutions that FICOM supervises and of government.

The Minister has an important role in providing policy direction, and we respect the need to balance that role with the goal of assuring independent supervisory and regulatory decision-making. In our view, policy directions would best be provided in the form of legislation, regulation or mandate letters from the Minister; providing any policy directions in that manner would promote greater clarity, transparency and accountability.

Finally, we recommend that the Commission Chair and the Minister meet regularly to facilitate open communication and understanding of government policy and regulatory matters where they intersect.

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<sup>13</sup> *Supra*, Note 3.

<sup>14</sup> The Commission delegates most day-to-day supervision responsibilities to the Superintendent, with the exception of the powers listed under s. 201 of the FIA, which the Commission is not permitted to delegate.

## Guidelines

### **R-7: The FIA delineate the Commission's authority to issue guidelines after conducting mandatory public consultation on draft guidelines and following due process.**

We strongly concur with the consultation paper that issuing guidelines can be an important supervisory tool because they clarify supervisory expectations and allow for timely direction to financial institutions to address emerging risks. Guidelines that the Commission can amend as circumstances warrant also help to ensure that prudential standards remain effective and relevant to changing industry norms, practices and structure. We therefore recommend that the FIA delineate the Commission's authority to issue guidelines to foster the effective supervision of British Columbia financial institutions. Furthermore, the legislation should provide the Superintendent with additional tools necessary to encourage adherence to the guidelines as appropriate. (We will discuss these tools further below.)

With increased flexibility comes increased responsibility. This requires appropriate checks and balances to ensure complete transparency and fairness within the guideline-making process. We recommend incorporating mandatory public consultation on draft guidelines within the legislation.

## Supervisory Tools and Expert Staff

### **R-8: FICOM be provided with additional well-tailored, proportionate tools and the ability to hire and retain sufficient expert staff to exercise its powers fairly and appropriately and in a timely manner.**

### **R-9: The FIA incorporate the best supervisory practice of extending privilege to certain supervisory information.**

International regulatory standards, as well as Canadian federal and provincial supervisory practice, emphasize continuous review and evaluation of the governance and risk management of financial institutions. Furthermore, it is recognized that regulators must have appropriate tools to make timely interventions to address prudential problems at an early stage.

Revised legislation should give FICOM additional tools based on two key principles. First, some supervisory information and communications should be privileged, in keeping with established best supervisory practices and jurisprudence. Requiring an institution to make public undertakings could unnecessarily undermine confidence in the institution. Financial institutions should be free to speak openly with their regulators without fear of having confidential information divulged publicly. Supervisors, for their part, should be able to clearly identify concerns and intervene early with moderate incremental measures without fearing negative market consequences that might aggravate any emerging problems.

Second, as generally used by other prudential authorities in the day-to-day supervision of financial institutions, there should be a graduated supervisory tool set beyond those currently available. For example, the FIA should give FICOM clear authority to enter into confidential prudential action plans with institutions and to restrict the business activities of an institution until action plans are completed or identified risks are otherwise reduced. More calibrated tools would allow FICOM to enforce its guidelines without having to resort to the limited, dated enforcement options available under the current legislation; they are not well-tailored to the particular risky behaviour FICOM is attempting to curb.

A prudential regulator's tool kit includes making use of best practice supervisory monitoring techniques such as horizontal reviews and market surveillance to detect emerging areas of risk. Effective deployment of this sophisticated tool kit is predicated on having a well-resourced, well-trained, independent cadre of supervisors. Staff must be able to exercise sound judgement to identify emerging problems and take measured steps at an early stage to reduce risks before they threaten financial stability.

Several assessments, including the March 2014 report of the British Columbia Auditor General, have identified a disturbing fact.<sup>15</sup> FICOM has been unable to attract and retain enough competent, qualified staff to discharge its mandate effectively and in a timely fashion, thereby increasing risk to the British Columbia financial system. The challenge in attracting and retaining sufficient qualified staff is directly related to the highly competitive environment for skills in financial sector risk management. The Auditor General's report stated "With their shortage of staff, it would take over 14 years to review all of British Columbia's credit unions instead of FICOM's intended target of two to three. The Ministry needs to work with FICOM to resolve this issue."<sup>16</sup> These observations remain all too valid. As of August, 2015, the Financial Institutions Division of FICOM had a vacancy rate of 41% (27 vacancies out of 66 positions). Further, FICOM has experienced significant challenges in hiring and retaining experienced leadership to oversee the delivery of the Financial Institutions Division mandate; there were six vacancies out of 13 positions (46%) on the Supervision Team and four vacancies out of nine positions (44%) on the Regulations Team.

Staffing challenges will become even more acute as FICOM's role expands in 2017 when the federal Office of the Superintendent of Financial Institutions (OSFI) relinquishes supervisory responsibilities of central credit unions. The proposed addition of recovery and resolution planning frameworks within the British Columbia supervisory framework will further add to staff workload. (Both items are discussed further below.)

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<sup>15</sup> Office of the Auditor General of British Columbia, *Credit Union Supervision in British Columbia*, March 2014.

<sup>16</sup> *Ibid.*

## **FINANCIAL INSTITUTION ISSUES**

### *Governance and Risk Management*

***R-10:* The FIA require effective risk management of financial institutions including a committee of an institution's board to oversee all risks in the institution as set out in guidelines issued by the Commission.**

In September 2013, FICOM established a governance guideline for British Columbia credit unions that, with the addition of more calibrated tools to facilitate compliance (Recommendations 8 and 9 on tools above), would empower FICOM to foster appropriate risk-based governance that is proportionate to the size, complexity and risk profile of the financial institution.<sup>17</sup>

The FIA requirement for a board-level investment and loan committee is too narrowly defined as it is focused only on credit risk. Current best practice requires that the board of a financial institution oversee *all* risks and consider them on an integrated basis. Requirements related to a board's responsibilities, such as setting up a committee to oversee risk in the institution, would be better set out in guidelines rather than embodied in legislation; this would allow efficient amendment over time as governance best practices evolve. This flexibility would allow the Superintendent, for example, to ensure that credit unions carry out board risk committee requirements in a manner consistent with the risk profile of the institution. For example, smaller or less complex institutions might be permitted to combine the risk review function with another committee such as the audit committee.

All credit unions should have a board-approved risk appetite and an integrated risk management framework. In larger institutions, a Chief Risk Officer (CRO) who is independent of front-line business decision-making should carry out this framework. In smaller or less complex institutions, the CRO function could be combined with other control responsibilities, such as the Chief Financial Officer function. However it is structured, the key point is that risk management should not rest solely in the hands of the people who are making loans or otherwise assuming risk on behalf of the institution.

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<sup>17</sup> Governance Guideline, September 2013:  
<http://www.fic.gov.bc.ca/pdf/creditUnionsTrusts/GovernanceGuidelineCUs.pdf>

## Capital and Liquidity Requirements

### **R-11: The FIA require that financial institutions hold adequate and appropriate forms of capital and liquidity as set out in guidelines issued by the Commission.**

Our overarching recommendation regarding capital and liquidity requirements is that the legislative framework should avoid any hard-wiring of quantitative requirements that cannot be adjusted in a timely fashion to mitigate risk and emerging concerns. The various federal financial institution statutes (e.g., *Bank Act*, *Trust and Loan Companies Act* and the *Cooperative Credit Associations Act*)<sup>18</sup> require federally regulated financial institutions to hold adequate capital and liquidity. However, it is OSFI guidelines on Capital Adequacy, Leverage and Liquidity Requirements that provide the framework within which the federal Superintendent assesses whether a federally-regulated financial institution has adequate capital and liquidity pursuant to the federal acts.<sup>19</sup> Accordingly, we recommend that the FIA continue to require that financial institutions hold adequate and appropriate forms of capital and liquidity but delete all current references to specific targets, which should instead be set out in guidelines issued by the Commission.

### Standards for British Columbia Credit Unions

OSFI guidance is based on the global Basel II and III standards. As pointed out in the Ministry's consultation paper, "BC's legislative framework is still primarily based on Basel I."<sup>20</sup> There is good reason to adopt the latest standards in British Columbia, with certain exceptions to take into account the unique nature of the British Columbia credit union system. In particular, there are several British Columbia-specific risk considerations that argue for a stronger capital and liquidity regime: (1) the unlimited deposit insurance guarantee; (2) the concentration of deposits and loans in two credit unions representing about 50 percent of all credit union deposits and loans in the province; (3) credit unions' focus and concentration on residential and commercial real estate in the province; and (4) limited access to capital markets given the nature and structure of credit unions. Accordingly, consideration should be given to not only meeting, but exceeding the Basel III standardized capital requirements.

Basel III standards for liquidity requirements also are appropriate, provided that they are adjusted for the specific characteristics of the British Columbia credit union system. For example, the notion of a Liquidity Coverage Ratio (highly liquid assets equal to or greater than an institution's net cash over a 30-day period) is appropriate. However, the liquidity framework would have to

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<sup>18</sup> *Bank Act* (S.C. 1991, c. 46); *Trust and Loan Companies Act* (S.C. 1991, c. 45); *Cooperative Credit Associations Act* (S.C. 1991, c. 48)

<sup>19</sup> OSFI Guidelines Table found at: <http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/default.aspx#cpt>

<sup>20</sup> British Columbia Ministry of Finance, *Financial Institutions Act & Credit Union Incorporation Act Review, Initial Public Consultation Paper*, p. 23.

be tailored to recognize that credit unions hold liquidity at Central 1, which is a current legislative requirement.<sup>21</sup>

## **FINANCIAL SYSTEM ISSUES**

### *Systemic Designation, Resolution Authority and Emergency Liquidity*

***R-12:* The FIA delineate the Commission’s authority to designate institutions as systemically important. Once designated, these institutions may be subject to additional prudential requirements necessary to mitigate systemic risk including the preparation of recovery and resolution plans, as set out in guidelines issued by the Commission.**

FICOM has identified Central 1 as a domestically systemically important financial institution (D-SIFI) in British Columbia with accompanying regulatory and supervisory implications.<sup>22</sup> It is now considered best practice for legislation to provide the authority to designate D-SIFIs, and enable additional prudential requirements needed to mitigate systemic risks. This should include the requirement for D-SIFIs to prepare recovery and resolution plans in order to prepare for the recovery of a distressed financial institution and the efficient resolution, expeditious liquidation of assets, fair treatment of creditors and continuation of critical systemically important functions—should it come to that.

Accordingly, we recommend that the FIA delineate the Commission’s authority to designate institutions as systemically important. The designation process should include the same indicators that were considered in identifying Central 1 as a D-SIFI (interconnectedness, limitations on substitutability, complexity and size).<sup>23</sup>

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<sup>21</sup> Centralizing liquidity management for a network of credit unions to one central credit union provides scale and efficiency to the credit union system and is standard practice in cooperative financial institutions worldwide. However, the legislative requirement that all British Columbia credit unions must hold their statutory liquidity with Central 1 has the potential to create systemic risk. Thus, it is important that FICOM has the authority and tools to exercise its effective supervision and surveillance of Central 1, and can impose expectations on integrated risk management, liquidity management, eligible investments, capital adequacy, recovery and resolution planning, new products and activities approval framework, etc to mitigate this systemic risk.

<sup>22</sup> Central 1 identification letter, regulatory and supervisory implications can be found at: [http://www.fic.gov.bc.ca/pdf/info\\_bulletins/CU-14-001.pdf](http://www.fic.gov.bc.ca/pdf/info_bulletins/CU-14-001.pdf).

<sup>23</sup> At the federal level, OSFI publishes its considerations for designating domestic banks as systemically important within Annex 1 of its Capital Adequacy Requirements Guidelines: [http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR\\_chpt1.aspx#1.11](http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR_chpt1.aspx#1.11). The Bank of Canada designates systemically important payment, clearing and settlement systems.

**R-13: The FIA establish an effective resolution regime that addresses the following areas:**

- viii. The Commission determine when a financial institution is no longer able to assure viability and should be resolved.**
- ix. FICOM be designated as the resolution authority for British Columbia.**
- x. The FIA provide the necessary authority to ensure sufficient liquidity in a crisis, including Emergency Lending Assistance from the Bank of Canada.**

To ensure that the province is prepared for a crisis affecting any financial institution, we further recommend that FICOM be named as the resolution authority for the province of British Columbia. This would include the Commission having responsibility for triggering resolution after determining a financial institution is no longer able to assure viability on its own. Clearly delineating the roles of the Minister, Commission, Superintendent and CUDIC in a financial crisis will be essential to building a comprehensive and robust resolution regime. The legislative framework should be particularly clear as it relates to the roles of FICOM and CUDIC given the Commission and Superintendent have leadership and decision-making roles in each of these organizations. Legislative arrangements should be carefully constructed to ensure that there is no conflict between FICOM's prudential role and as the resolution authority and CUDIC's administrative responsibility for deposit insurance.

Funding and liquidity are often in short supply during periods of severe financial stress, particularly during the early stages of resolving a financial institution. A sound resolution regime should ensure that mechanisms exist to assure sufficient funding and liquidity during a crisis, including any use of the deposit insurance fund. Seeking Bank of Canada Emergency Lending Assistance (ELA) could also become necessary. In its May 2015 consultation paper on emergency lending, the Bank of Canada proposed that a provincially-regulated credit union, *caisse populaire* or central credit union would only be eligible for ELA if it met four requirements: (i) the firm be a member of the Canadian Payments Association (CPA)<sup>24</sup>; (ii) the province provide an indemnity against losses incurred by the financial institution; (iii) ELA be necessary to support the stability of the Canadian financial system; and (iv) the firm have a credible recovery and resolution framework.

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<sup>24</sup> Currently, section 4(2) of the *Canadian Payments Act*, R.S.C., 1985, c. C-21, prohibits a local credit union that is a member of a central from becoming a member of the Association. In light of the recent Bank of Canada ELA proposal, should FICOM deem it necessary to designate as systemically important a credit union that is not a central, discussion would need to ensue between FICOM, the Bank of Canada and the Canadian Payments Association regarding this provision.



## Central Credit Unions

**R-14: The FIA provide that a central credit union be subject to the same prudential standards and guidelines as all other credit unions in the province of British Columbia and any additional measures that apply to institutions designated as systemically important.**

Under the current legislation, a central credit union is treated differently than all other credit unions. As a result, FICOM's ability to exercise supervisory authority over a central credit union is more constrained than for other credit unions. Even if a serious breach occurred that would permit FICOM to intervene, the process for taking supervisory action is slow and cumbersome and the enforcement tools available are limited and relatively severe.<sup>25</sup> The current legislative scheme does not facilitate continuous risk-based supervision of a central credit union or graduated early intervention measures to deal with issues before they threaten financial stability. This is no longer adequate. A central credit union should be subject to the same prudential standards and guidelines as all other credit unions in the province. Furthermore, as a systemically important financial institution, it should also be subject to additional requirements necessary to mitigate systemic risks.

The inadequacy of the current enforcement tools will become more pronounced when OSFI ceases to supervise central credit unions nationally as of January 15, 2017, leaving FICOM as the primary regulator of Central 1.

The activities of Central 1 go well beyond the boundaries of the province. It plays a crucial role in providing payments, clearing and liquidity services to credit union systems across the country (excluding Quebec). FICOM will need the authority to consider extra-provincial supervision issues arising out of Central 1's role in Ontario, and its involvement in liquidity agreements with centrals from other provinces when exercising its responsibilities as primary regulator of Central 1.<sup>26</sup> Further, FICOM will undoubtedly need more staff with a high level of supervisory expertise to take on the supplementary responsibilities vacated by OSFI. We therefore recommend that FICOM have the legislative authority, tools and resources to conduct risk-based supervision and

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<sup>25</sup> The test within sections 244 and 248 of the FIA for FICOM to exercise its supervisory authority over a Central Credit Union is quite onerous (e.g., a breach of the Act or regulations, failure to comply with a business authorization or a written undertaking, or where it might reasonably be expected that harm will be caused to depositors). Even once the test is met, FICOM must order the Central Credit Union to hold a special general meeting, which the Central must call within 30 days. Tools for such breaches include revocation of a business authorization and the appointment of a receiver.

<sup>26</sup> Per Central 1's 2014 Annual Report, p. 34; Central 1's average assets in 2014 were \$12.9 Billion. Central 1's assets consist primarily of liquid securities and fully secured loans to credit unions. The proportions of these fluctuate with the levels of liquidity in the system and the demand for loans from Central 1 by its members. Central 1's liabilities consist primarily of deposits from credit unions. Central 1 has a mandatory source of funding through the regulatory requirement that British Columbia credit unions maintain deposits with Central 1 and through Liquidity Agreements with Ontario member credit unions. Central 1 supplements mandatory deposits with deposits of excess liquidity from credit unions and deposits from organizations external to the system.

apply graduated early intervention measures to central credit unions before they threaten financial stability.

### Major Transactions

**R-15: The FIA provide FICOM with the authority to approve, reject and impose prudential conditions on all major transactions (i.e. acquisitions, divestitures or investments) by a financial institution.**

As noted in the consultation paper, the FIA and CUIA do not set out clear criteria for the approval of major transactions. Transactions that might affect the risk profile of the credit unions involved or that might threaten financial system stability should require FICOM approval.

We recommend that the FIA give FICOM the authority to approve or reject and impose prudential conditions on all major transactions. In addition to identifying prudential and systemic risk considerations as the criteria for FICOM to base its determination, a threshold based on the significance and risk impact should be established for FICOM approval. This will clarify what types and size of major transactions require prior supervisory approval and cases where notification after the transaction has occurred is sufficient (i.e., where the acquisition is small relative to the financial institution's capital).

## **MEMBER AND CUSTOMER ISSUES**

### Ombudsperson

**R-16: An ombudsperson for financial institutions be designated to provide a mandatory alternate dispute resolution mechanism for members and customers who are dissatisfied with a retail service or product provided.**

We believe that the current framework for market conduct supervision in British Columbia is sound, as long as FICOM has enough expert staff to carry out the job. However, as credit unions expand their membership and as the products they offer become more sophisticated, it would be beneficial to create more structured mandatory mechanisms to help resolve any disputes about the provision of financial services for which a customer or member would have no recourse other than going to court. Options for such mechanisms include, for example, a new ombudsperson office in British Columbia and the existing federal Ombudsman for Banking Services and Investments (OBSI), whose services are now used by Saskatchewan credit unions.

### Disclosure and Voting Practices

**R-17: The FIA authorize the Commission to require credit unions to adopt disclosure and voting practices that will engage members, provide them with adequate information and encourage the exercise of voting rights, as set out in guidelines issued by the Commission.**

Credit union members are expected to hold credit unions accountable for their decisions through the exercise of their voting rights. To enable members to fulfil this role, credit unions must provide members with adequate information. There are inconsistencies among credit unions regarding the provision of information to members to allow them to make informed choices on matters subject to their decisions (e.g., selection of directors, mergers, acquisitions). Technology can be used to modernize disclosure and voting processes and foster informed member engagement in a cost-effective manner. Once the FIA provides the necessary authority, the Commission would establish guidelines to ensure that all credit unions adopt common baseline practices for voting and disclosure practices.

### Deposit Insurance

**R-18: The government review unlimited deposit insurance and, as soon as circumstances permit, move to limit such coverage with careful planning of the transition.**

The danger of unlimited deposit insurance is that lenders, knowing that their depositors are fully protected by government, might take excessive risk; this situation is an example of moral hazard. Although British Columbia has some measures to mitigate moral hazard (e.g., risk-adjusted premiums, prudent regulatory requirements and timely intervention mechanisms), additional measures should be adopted even if coverage is limited. These measures include more intensive supervision, the implementation of an effective recovery and resolution framework and others included in the recommendations we have made above in this response.

As for the question of whether a limit on deposit insurance protection should be introduced, the Commission concurs with the recommendations of the Basel Committee on Banking Supervision and the International Association of Deposit Insurers (IADI) noted on page 19 of the Ministry's consultation paper. Their recommendations include requiring that: (1) deposit insurance adequately cover a large majority of depositors with coverage that is limited but credible; and (2) jurisdictions with unlimited deposit insurance move to limit such coverage as soon as their circumstances permit, with careful planning of the transition due to the importance of deposit insurance in maintaining public confidence.

The Commission recognizes that any proposal to reintroduce limits on deposit insurance entails public policy and other considerations that go beyond the Commission's mandate to consider. Our recommendation is that as soon as circumstances permit, the province move towards introducing a limit on deposit insurance, with careful planning of the transition.

## **CONCLUSION**

The Ministry of Finance consultation paper raises numerous important issues that merit thoughtful discussion. We have chosen to not cover all topics, but rather to focus on items closest to our mandate and responsibilities. Further, we have identified areas where modernization of the British Columbia legislative framework is necessary to reflect current understanding of what is required for sound prudential supervision of deposit-taking institutions and address matters of concern that have arisen in the exercise of FICOM's prudential supervision mandate.

We would be pleased to elaborate on our recommendations and would appreciate the opportunity to meet with Ministry staff to discuss them. If you wish our input on an issue we have not addressed, we would be happy to provide our views.

Thank you for the opportunity to participate in this most important consultation.