

*Financial Institutions Act &  
Credit Union Incorporation Act*  
Review  
**Initial Public Consultation Paper**



Ministry of  
Finance

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**FINANCIAL INSTITUTIONS ACT & CREDIT UNION INCORPORATION ACT REVIEW**

**INITIAL PUBLIC CONSULTATION PAPER**

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## INTRODUCTION

The Ministry of Finance has commenced a broad review of the *Financial Institutions Act* (FIA) and the related *Credit Union Incorporation Act* (CUIA). The FIA provides the regulatory framework for credit unions, insurance companies and intermediaries, and trust companies, and the CUIA provides the framework for incorporation and corporate governance of credit unions.

The goal of this regulatory framework is to maintain stability and confidence in the financial services sector by reducing the risk of failures and providing consumer protection. To ensure that the regulatory framework continues to be effective, efficient and modern, both statutes contain a requirement that a review of the legislation be initiated every ten years.

### Purpose of Initial Public Consultation Paper

The purpose of this initial public consultation paper is to seek input for the review of the FIA and CUIA. The paper sets out a number of key issues and specific areas on which input and comments are being sought. Stakeholders are also invited to provide comments on other issues with the regulatory framework they would like considered as part of the review.

### How to Provide Input

**Submissions and comments must be received by September 15, 2015 and may be transmitted electronically to [fiareview@gov.bc.ca](mailto:fiareview@gov.bc.ca).**

Submissions and comments may also be mailed to:

FIA & CUIA Review  
Policy & Legislation Division  
Ministry of Finance  
PO Box 9470 Stn Prov Govt  
Victoria BC V8W 9V8

### Public Nature of Consultation Process

Please note that this is a public consultation process and, unless confidentiality is specifically requested, comments and submissions may be summarized or attributed in a public report, and may also be disclosed to other interested parties or made publicly available on the Ministry of Finance website at <http://www.gov.bc.ca/fin/>.

If certain comments should not be posted publicly or shared with other parties, please clearly indicate that in the submission or covering letter. However, please note that all submissions received are subject to the *Freedom of Information and Protection of Privacy Act* and, even where confidentiality is requested, this legislation may require the Ministry to make information available to those requesting such access.

## BACKGROUND / CONTEXT

### British Columbia's Financial Services Sector

#### *Credit Unions*

British Columbia has 42 independent credit unions with more than 1.9 million members and over 8,400 employees.<sup>1</sup> BC credit unions hold more than \$50 billion in insured deposits and have more than \$60 billion in assets (as of the end of 2014).<sup>2</sup> BC's credit unions range in membership from roughly 1,400 to over 500,000, and their assets range from just over \$10 million to approximately \$18.5 billion.<sup>3</sup>

Credit unions are financial cooperatives owned by their members. They offer a full range of financial services, similar to those offered by Canadian banks. Credit unions play an important role in BC communities, including in underserved small and remote communities, and contribute to local economic and social development.

#### *Insurance Sector*

The insurance sector in BC is comprised of a number of local and national insurance companies. There are six BC incorporated insurance companies offering property and casualty insurance and two offering life insurance. They primarily serve British Columbians, although some also have operations in other provinces. In addition, there are 222 extra-provincial insurers authorized in the province. Extra-provincial insurers serve 97 percent of the BC property and casualty market and 93 percent of the BC life insurance market (by premium value).

Insurance intermediaries are an important part of the insurance sector. Insurance agents and brokers sell automobile, life, health, home and other types of insurance to individuals and businesses. An insurance agent generally represents a specific insurer, whereas a broker can represent a number of different companies. BC has more than 800 property and casualty insurance brokerages that employ over 8,400 British Columbians, and an estimated 13,300 life and/or health insurance agents working from branch offices and agencies across the province.<sup>4, 5</sup>

#### *Trust Companies*

There are five trust companies incorporated in BC. They provide trust-only services in the province. There are 40 federally incorporated and two provincially incorporated extra-provincial trust companies operating in the province. Most offer both deposit-taking and trust services.

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<sup>1</sup> Central 1 Credit Union, <http://www.central1.com/about-us/credit-union-system>.

<sup>2</sup> Credit Union Central of Canada, *National System Review*, Fourth Quarter, 2015, [http://www.cucentral.ca/FactsFigures/4Q14SystemResults\\_\\_5-Mar-15.pdf](http://www.cucentral.ca/FactsFigures/4Q14SystemResults__5-Mar-15.pdf).

<sup>3</sup> Central 1 Credit Union.

<sup>4</sup> Insurance Brokers Association of BC, <http://www.ibabc.org/get-to-know-us/about-ibabc.html>.

<sup>5</sup> Canadian Life and Health Insurance Association, *Life and Health Insurance in BC*, <http://clhia.uberflip.com/i/395998-life-and-health-insurance-in-british-columbia-2014-edition/5?>

## Rationale for Regulating the Financial Services Sector

Financial sector stability and consumer protection are important public policy objectives for government. Although there are other sectors that represent a greater portion of gross domestic product (GDP) and employment, governments dedicate significant time and resources to regulation of the financial services sector because issues in the sector can have disproportionately large impacts on the economy and society in general.

An effective regulatory framework helps to ensure that British Columbians continue to benefit from a financial services sector that is strong, stable, and inspires public confidence and trust. Regulation of financial institutions and intermediaries should be balanced, so that it is both effective and efficient, and does not place an undue burden on financial institutions, stifle innovation, or create barriers to new institutions.

Financial sector regulation in BC has proven effective, and BC's financial sector remained stable and strong, even through the global financial crisis. Credit unions, insurers and insurance intermediaries, and trust companies continue to make significant contributions to British Columbia's economy and to communities throughout the province.

Although much has changed in the decade since the previous review, government remains committed to providing an effective and balanced regulatory framework which protects the interests of depositors, policyholders, beneficiaries, members and the public, while ensuring the financial services sector is able to innovate, take reasonable risks, and compete effectively.

## Financial Services Sector Legislative and Regulatory Framework

The *Financial Institutions Act* (FIA) provides the regulatory framework for credit unions, insurance companies and intermediaries, and trust companies, and the related *Credit Union Incorporation Act* (CUIA) provides the framework for incorporation and corporate governance of credit unions.<sup>6</sup> The goal of this regulatory framework is to maintain stability and confidence in the financial services sector by reducing the risk of failures and providing consumer protection.

### *Financial Institutions Commission*

The Financial Institutions Commission (Commission), along with the Superintendent of Financial Institutions (Superintendent), is responsible for regulating and supervising financial institutions in British Columbia – credit unions, insurance companies, and trust companies – to determine whether they are in sound financial condition and complying with their governing laws (the FIA and CUIA) and supervisory standards.

The Commission is established under the FIA and its members are appointed by the Lieutenant Governor in Council. The Commission must comply with policy directions issued by the Minister of Finance with respect to the exercise of its powers and performance of its duties. The Superintendent is appointed by the Lieutenant Governor in Council, after consultation with the Commission Chair, and the Commission provides oversight and direction to the Superintendent.

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<sup>6</sup> Not all provisions governing the insurance industry are contained in the FIA. The *Insurance Act* provides part of the consumer protection regulatory framework for the insurance sector. It was reviewed and updated in 2009.



The Commission may delegate most of its powers and duties to the Superintendent, with the exception of major regulatory decisions such as consent to incorporation, amalgamation, etc., and, in practice, the Superintendent undertakes the day-to-day regulatory functions (and may in turn delegate certain powers and duties to staff).

While the acronym “FICOM” is used to refer both to the Commission itself and to the organization headed by the Superintendent which supports the Commission, for purposes of this paper a reference to FICOM is a reference to the Commission as it is the Commission which has the statutory authority for the regulation of financial institutions in BC.<sup>7, 8</sup>

### ***Review of the *Financial Institutions Act* and *Credit Union Incorporation Act****

To ensure that the regulatory framework continues to be effective, efficient and modern, both the FIA and CUIA contain a requirement that a review of the legislation be initiated every ten years.

The review will consider the regulatory tools BC has to oversee credit unions, insurers and intermediaries, and trust companies, and whether changes to the regulatory framework are needed.

This review forms part of the Ministry of Finance’s ongoing revision of important framework statutes in the corporate, real estate, pensions and financial services sectors. In recent years this process has resulted in several pieces of new or revised legislation.

#### ***Initial Public Consultation Paper***

This initial public consultation paper identifies and describes a number of important issues on which government is seeking input, and poses a series of questions related to each issue. Its purpose is to seek input from stakeholders in the financial services sector, and other interested parties and members of the public, for consideration as part of the review of the FIA and CUIA.

#### ***Next Steps and Further Public Consultations***

A public report on the input received will be prepared and released after the consultation period has ended.

Further public consultation will be undertaken in a later phase of the review. After analysis of the issues and input received during the initial consultation period, and development of proposed policy and legislative changes, the Ministry plans to prepare and release a second consultation paper which identifies the proposed policy and legislative changes and seeks further public input.

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<sup>7</sup> The Superintendent also holds certain powers under the FIA that are separate and apart from those held by the Commission.

<sup>8</sup> In a few cases when discussing issues related to specific powers and duties that may not be delegated by the Commission, “the Commission” will be used instead of “FICOM”.

## Objectives of the Legislative and Regulatory Framework

The objectives will help to guide the analysis of issues during the review (i.e., government will consider whether a proposed change helps to ensure that the regulatory framework as a whole meets these objectives).

The primary goal or objective of the FIA and CUIA regulatory framework for financial institutions and their intermediaries is:

- ❖ To maintain stability and confidence in the financial services sector by reducing the risk of failures and providing consumer protection.

There are also a number of important complementary and supporting objectives:

- To create an environment where the financial services sector, and the entities within it (i.e., financial institutions and intermediaries), can continue to grow and prosper.
  - For example, does the proposed change help to reduce red tape and unnecessary regulations that hinder economic development?
- To promote sound risk management and appropriate/responsible risk-taking.
  - For example, does the proposed change help to foster good governance and a comprehensive risk management process in regulated institutions?
- To enable early detection and timely intervention and resolution of issues.
  - Does the proposed change help to ensure that the legislation provides the regulator with an adequate range of supervisory tools so that problems can be detected early, and intervention made in a timely matter to resolve issues?
- To reflect international standards, while respecting the particular needs and circumstances of BC's financial sector and taking into account the nature, structure, size, scope and complexity of institutions.
  - Does the proposed change take into account international standards and best practices, while also considering significant differences in the size and complexity of organizations to ensure the approach is appropriate for all entities in BC's financial sector?
  - Do structural and ownership differences among financial institutions (e.g., cooperative or mutual organizations) necessitate different approaches?
- To foster member engagement in cooperative and mutual financial institutions.
  - Does the proposed change help to encourage member involvement and engagement and provide members with the information they need about issues that impact them?



## DISCUSSION OF KEY ISSUES AND AREAS FOR PUBLIC INPUT

### Overview

The remainder of this paper identifies and briefly describes the key areas and issues about which government is seeking input for consideration as part of the FIA and CUIA review. The intent of this initial paper is not to present conclusions about the issues, or to propose specific policy changes. The intent is to raise a number of important issues for discussion, and to provide an opportunity for everyone in the financial services sector, and all other interested parties, to comment and provide input.

The issues are grouped into four main sections: a general section which contains the issues that likely impact all financial service sectors (i.e., credit unions, insurers and insurance intermediaries, and trust companies); and a separate section for each of the credit union, insurance and trust sectors which contains the issues that primarily, or exclusively, apply to that sector. A series of related questions are posed after each issue is described to help identify the specific areas and issues about which input is being sought.

Stakeholders are also invited to provide additional input and comments on the issues (e.g., if they would like to comment on issues other than those specifically raised in the questions), and are encouraged to provide comments and input on any other issues or concerns with the regulatory framework (i.e., those not identified in the paper) they would like considered in the review.

## OVERALL / FRAMEWORK ISSUES

### **Issue 1: Financial Consumer Protection**

Consumer confidence and trust are essential for an efficient financial market. Governments provide financial consumer protection through laws designed to prevent fraud and unfair practices and protect the most vulnerable members of society. Voluntary and industry codes can provide additional consumer protection.

In recent years regulators have increasingly focused on ensuring consumers of financial products and services are treated fairly. In 2011, the Organisation for Economic Co-operation and Development (OECD) published financial consumer protection principles.<sup>9</sup> The federal government is considering and consulting on a similar set of principles, and the Quebec financial services regulator recently released a guideline which sets out expectations for financial institutions' commercial practices.<sup>10, 11</sup>

BC does not have a specific market conduct code for fair treatment of consumers, although the FIA has some provisions that deal with the market conduct of BC's financial institutions, including prohibitions on coercive tied selling and requirements for disclosure of conflicts of interest. In addition, consumer protection rules under the *Business Practices and Consumer Protection Act* apply generally (though not specifically) to the provision of financial services. The *Insurance Act* also regulates market conduct of insurers through requirements respecting the insurance contract.

#### Related Issues:

##### *Ombudservices*

Canadian jurisdictions, including BC, require insurers to implement internal processes for the resolution of consumer complaints, and most insurers are also required to belong to an ombudservice (e.g., the General Insurance OmbudService for property and casualty insurers and the OmbudService for Life & Health Insurance). These ombudservices provide a second line of recourse for unsatisfied consumers, by offering free assistance to help resolve disputes.

While some BC credit unions have published complaints procedures, BC credit unions are not currently required to have internal dispute resolution processes and there is no standard complaint handling process or access to an independent ombudservice. Government has rarely received complaints about credit union conduct, and credit union consumers are members with the ability to influence organizational governance. However, as credit unions continue to expand their membership and increase the sophistication of products offered, the implementation of more structured rules on dispute resolution may be beneficial.

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<sup>9</sup> OECD, *G20 High-level Principles on Financial Consumer Protection*, October 2011, <http://www.oecd.org/daf/fin/financial-markets/48892010.pdf>.

<sup>10</sup> Department of Finance Canada, *Canada's Financial Consumer Protection Framework: Consultation Paper* (archived), <http://www.fin.gc.ca/activty/consult/fcpf-cpcpsf-eng.asp>.

<sup>11</sup> Autorité des marchés financiers, *Sound Commercial Practices Guideline*, [http://www.lautorite.qc.ca/files/pdf/reglementation/lignes-directrices-assurance/g\\_scp\\_2013.pdf](http://www.lautorite.qc.ca/files/pdf/reglementation/lignes-directrices-assurance/g_scp_2013.pdf).

In Saskatchewan, credit unions follow an industry standard process for complaint handling that provides a timely response to member complaints, designates a compliance officer or senior executive who will be responsible for handling complaints, and escalates unresolved complaints to an Office of the Ombudsman established by the credit union system. The Saskatchewan credit union system has also joined the Ombudsman for Banking Services and Investments, an external impartial organization, to help with matters that are not resolved by the credit union or credit union ombudservice.

### *Branch Closures*

In 2002, the federal government adopted regulations which require banks to give up to six months' prior notice and consult with affected communities about the closure of a bank branch. The regulations do not prohibit closures. Adoption of similar regulations in BC was not contemplated at that time as credit union branch closures are rare and credit unions have often stepped in to fill the place of other financial institutions leaving smaller communities. However, concerns have been raised recently about credit union branch closures.

### *Use of Corporate and Business Names*

The CUIA requires that credit unions have a legal name which includes “credit union” and requires that legal name to be displayed and used in certain circumstances. The FIA requires every financial institution to clearly state its identity in all advertising, correspondence, etc. Business branding is important, and the legislation does not prohibit the use of a business name, trade name or logo by a credit union as part of its business branding strategy. However, it is essential that the identity of financial institutions be clear to consumers.

### Questions:

- 1) Should BC consider adopting a market conduct code for fair treatment of consumers that would apply to financial institutions? If so, should there be one code for all financial institutions or separate codes for different types of financial institution?
- 2) Should BC credit unions be required to have an internal complaint handling process and to offer member access to an independent ombudservice?
- 3) Should ombudservices be mandated for addressing consumer complaints against mutual insurers and/or insurance agents and brokers?<sup>12</sup>
- 4) Should authorization requirements for financial institutions and licensing requirements for insurance agents and brokers specifically require fair treatment of consumers?
- 5) Should branch closure notification rules be considered in BC, perhaps as part of a market conduct code? If so, what rules would be appropriate in BC?
- 6) Does BC have the correct framework for use of corporate and business names and logos, and the disclosure of identity for financial institutions?

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<sup>12</sup> Although there is no BC requirement to do so, mutual insurers have established an ombudservice for their industry, the Mutual Insurance Companies OmbudService.

## Issue 2: Market Discipline / Public Disclosure of Key Financial Risk Information

Consumers and investors can play an important role in imposing market discipline. The disclosure by financial institutions of comprehensive financial and risk information on a timely basis reduces uncertainty and allows consumers and investors to make more informed decisions about which institutions to do business with. Market discipline can promote safety and soundness in financial systems by reinforcing minimum capital standards and supervisory processes.<sup>13</sup>

The internet is the primary tool many consumers use to find information, including information about financial institutions. Regulators in a number of jurisdictions require financial institutions to disclose key financial and risk information, and some regulators (e.g., Alberta and Quebec) also provide this information on their own websites. The information the FIA requires financial institutions to make publicly available is limited (i.e., only the audited financial statements and auditor's report), and there is no requirement for information to be published electronically or available online.

### Related Issues:

#### *Information Sharing*

Many financial institutions such as trust companies and insurance companies operate in multiple jurisdictions. The ability of a regulator to collect and share relevant market conduct information (e.g., aggregate complaint data) with other supervisors and authorities is an important component of a proactive risk-based market conduct regulatory regime as it helps regulators to identify and address potential conduct issues.

In 2005, insurance regulators in Quebec and Ontario developed a joint complaint reporting system to reduce duplication and harmonize regulatory reporting. The system has since been expanded nationwide, providing other regulators with access and enabling companies to enter and disclose information to regulators in other provinces. BC is the only province that has not joined the system.

The FIA contemplates the exchange of information and gives FICOM broad powers to make agreements with other jurisdictions. However, it is not clear whether the FIA allows FICOM to share information with non-regulatory entities which collect and aggregate data on a national basis, or whether FICOM can compel financial institutions to do so.

### Questions:

- 1) Should BC financial institutions be required to make additional financial and risk information available publicly, including online? If so, which types of information? What are the benefits and risks or issues associated with more stringent public disclosure requirements?

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<sup>13</sup> Basel Committee on Banking Supervision, *Working Paper on Pillar 3 – Market Discipline*, September 2001, pg. 1, [http://www.bis.org/publ/bcbs\\_wp7.pdf](http://www.bis.org/publ/bcbs_wp7.pdf).

- 2) Should FICOM be permitted to publish information it collects from financial institutions online? Are there certain types of information that should not be published or exemptions that should be provided (e.g., to particular types or sizes of institution)?
- 3) Should financial institutions in BC be required to provide information to national databases for regulatory purposes, and should FICOM be allowed to do so?

### Issue 3: Financial Literacy

Financial literacy is “having the knowledge, skills and confidence to make responsible financial decisions.”<sup>14</sup> Financial literacy can benefit consumers by helping to improve their personal financial situation, and can potentially reduce the impact on government financial safety net programs. Consumer financial literacy complements the regulatory framework by increasing private sector and consumer oversight of financial institutions and their products.

Governments in Canada and around the world are focusing on ways to increase consumer financial literacy, and improving financial literacy has been on the agenda of Finance Ministers across Canada over the past five years. The Task Force on Financial Literacy established by the federal government recommended a national strategy to strengthen Canadians’ financial literacy and “believes strongly that financial literacy is critical to the prosperity of Canadians and the nation.”<sup>15</sup> BC has been a leader in this area, and the British Columbia Securities Commission (BCSC) in particular has introduced a variety of programs designed to increase consumer awareness of the importance of financial literacy. The BC government also has initiatives focused on protecting and improving the lives of seniors, who are a key target group for financial literacy, including the “Together to Reduce Elder Abuse – BC’s Strategy” (TREA Strategy).<sup>16</sup>

A number of initiatives are being undertaken by financial institutions, including banks, credit unions and caisses populaires, to train and assist front line staff to detect and address abusive situations.<sup>17</sup> Credit Union Central of Canada’s scan of financial literacy initiatives lists a significant number of credit union initiatives across Canada, including in BC.<sup>18</sup>

In the insurance sector, insurance organizations, companies and intermediaries support financial literacy with various online programs, community events, partnerships with other stakeholders and public outreach. Similar to front line staff at deposit-taking institutions, insurance agents

<sup>14</sup> Task Force on Financial Literacy (Canada), *Canadians and Their Money: Building a brighter financial future*, <http://www.financialliteracyincanada.com/pdf/canadians-and-their-money-1-report-eng.pdf>.

<sup>15</sup> Task Force on Financial Literacy (Canada), *A National Strategy on Financial Literacy: Overview of Recommendations*, <http://www.financialliteracyincanada.com/pdf/canadians-and-their-money-2-summary-eng.pdf>.

<sup>16</sup> British Columbia Ministry of Health, *Together to Reduce Elder Abuse – BC’s Strategy*, March 2013, <http://www2.gov.bc.ca/gov/DownloadAsset?assetId=A272C645C0BE4BC69FD41DC0EBOCCC2F>.

<sup>17</sup> Financial Consumer Agency of Canada, *National Strategy for Financial Literacy Phase 1: Strengthening Seniors’ Financial Literacy*, October 2014, pg. 7, <http://www.fcac-acfc.gc.ca/Eng/financialLiteracy/financialLiteracyCanada/Documents/SeniorsStrategyEN.pdf>.

<sup>18</sup> Credit Union Central of Canada, *Canadian Credit Union Scan of Financial Literacy Initiatives*, December 2010, [http://www.cucentral.ca/CUSR/resources/financial%20scan\\_final\\_rv\\_dec.2010.pdf](http://www.cucentral.ca/CUSR/resources/financial%20scan_final_rv_dec.2010.pdf). Credit Union Central of Canada is the national trade association for the Canadian credit union system.

and brokers have direct contact with consumers, which provides opportunities to increase consumer financial literacy through education about the benefits of managing risk through insurance, and which may also enable agents and brokers to detect potentially abusive situations.

Some financial literacy initiatives also include disaster preparedness. Although BC take-up rates for earthquake insurance are among the highest in the world (other than jurisdictions where it is mandated by law), there are still many consumers, even in very high risk areas, who do not purchase earthquake insurance. Surveys undertaken by the insurance industry suggest a number of factors may be involved, including a mistaken belief that government disaster relief funds would be available to compensate for losses. Both insurers and brokers have indicated governments should better communicate the non-availability of government disaster relief in situations where insurance can be purchased.

#### Related Issues:

##### *Reporting Financial Abuse*

In April 2014, the federal government tabled legislative amendments to broaden the powers of federally regulated entities to report suspected financial abuse, including to next of kin, and to disclose information without knowledge and consent of the affected individual.

Financial organizations have indicated that this provision will help them address some abusive situations by providing them with clearer authority to report suspected cases of financial abuse and also providing them with the option of contacting the next of kin or authorized representative of the individual who may have been the victim of financial abuse. BC legislation (*Adult Guardianship Act*) clearly permits any person to report suspected abuse or neglect to a designated agency, but there is no parallel authority to contact next of kin.

#### Questions:

- 1) What role should financial institutions and intermediaries play in contributing to and fostering financial literacy? Are there any legislative impediments to their doing so? Do financial institutions need additional tools to help fight financial abuse?
- 2) What role should the provincial government have with respect to promoting financial literacy? Is there a need to duplicate or complement efforts being undertaken at the federal level, particularly for provincially regulated institutions?
- 3) Should legislative changes to bolster financial literacy and/or protect consumers from financial abuse be considered?
- 4) The federal government has tabled legislation to permit federally regulated entities to report concerns about financial abuse to next of kin in specific circumstances. Should similar and/or other changes be considered with respect to BC financial institutions?
- 5) Do governments, including the BC provincial government, need to better communicate government policies in areas such as earthquake disaster relief? Are there other measures government should be taking with respect to earthquake or catastrophic loss insurance?



## Issue 4: Technological Change

Continuing advances in technology have significantly impacted how consumers access financial services and the way many businesses, including those in the financial services sector, operate. They have enabled financial institutions to offer new products and services (e.g., online sales and distribution of products) and access new markets, and have greatly increased choice and convenience for consumers. Technology also offers enhanced opportunities for member and consumer engagement.

While technological change has created many new opportunities, it also has the potential to create new risks for consumers and financial institutions. For example, in the past financial products and services were sold through brokers, agents or other regulated individuals, with personal interaction between the client and the seller where expert advice could be provided. The purchase of financial products and services online changes the manner in which consumers obtain information and advice, and the amount and quality of information obtained about products and services before decisions are made can vary greatly among consumers.

Technological change has also increased competitive pressures on local businesses (e.g., impact on pricing) as they face increased competition from online businesses in other jurisdictions. In addition, consumers may be storing and transmitting highly confidential information in new, potentially less secure ways and both consumers and financial institutions need to ensure that confidential data and information is protected and stored/transmitted securely.

### Related Issues:

#### *Access to Regulatory Information*

The FIA requires financial institutions to file certain information with the Superintendent of Financial Institutions on a regular basis and requires other information to be maintained and immediately accessible to the Superintendent. The increased use of electronic data storage, including cloud computing, often with vendors outside of Canada, may either assist financial institutions with meeting these requirements (e.g., quicker compilation of information) or create impediments (e.g., cross-jurisdictional issues and delays). FICOM may not have timely access to critical records and data due to the manner in which it is stored, location of storage (e.g., out of country), or the use of proprietary data systems, and may have no immediate way to compel third party data storage providers to release necessary data. Additionally, data stored in proprietary formats may not be readable by FICOM or other parties.

### Questions:

- 1) Are there any barriers or impediments to using new technology in the current legislative and regulatory framework (e.g., for member engagement, provision of products and services, etc.)? What changes are needed to ensure the regulatory framework continues to enable and accommodate technological change, now and in the future?
- 2) Are any changes needed to ensure consumers continue to be protected and provided with the information they need to make informed choices?

- 3) Are there certain financial products or services that should not be available for purchase directly by consumers online without using a professional broker or financial advisor at a regulated institution?
- 4) Are there consumer protection and regulatory issues related to record storage or retention? Should there be limits on what kinds of data can be entrusted to a third party service provider for storage and/or processing?

## Issue 5: Out of Province Business

### *Credit Unions*

In 2004, the FIA was amended to permit retail credit unions to operate extra-provincially on a reciprocal basis.<sup>19</sup> Prior to that, they were generally prohibited from doing business outside BC.<sup>20</sup> The CUIA requires that BC credit unions first obtain FICOM and Credit Union Deposit Insurance Corporation (CUDIC) approval, but does not provide any specific framework for exercising this discretion, other than that the credit union may only carry on such approved business “to the extent permitted under the laws of another jurisdiction.”

The BC framework uses a “home and host principal regulator” approach, with primary regulation and deposit insurance (for all deposits, including in respect of branches in other provinces) provided by the home jurisdiction.<sup>21</sup> This approach was adopted to reduce the regulatory burden by permitting host provinces to apply lighter and less costly regulatory oversight to credit unions from another jurisdiction.

In 2010, the federal government implemented changes to the *Bank Act* and the *Canada Deposit Insurance Corporation Act* to permit the creation of federal credit unions. These entities can operate across Canada (i.e., across provincial borders) subject only to federal regulation. To date, no federal credit unions have been incorporated under the new framework and no provincial credit union has applied to continue federally.

### *Insurance*

The federal and provincial governments share jurisdiction over foreign insurers in Canada, and BC and the federal government have different approaches to regulating insurance and determining whether licensing is required for particular insurance transactions.

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<sup>19</sup> This means that BC credit unions are able to operate in other jurisdictions, if permitted by the laws of that jurisdiction, and credit unions from other jurisdictions are able to operate in BC if the laws of their original jurisdiction permit operating extra-provincially, and the credit union is compliant with the statutory framework in BC and receives approval from FICOM and CUDIC. BC is currently the only province that has implemented a legislative framework for extra-provincial credit unions. While Saskatchewan and Ontario have legislation, regulations are still needed, either to bring into force the legislation or provide essential elements of its operation.

<sup>20</sup> There were exceptions relating to the capacity to perfect and register notes, mortgages, liens, etc. outside BC, and credit union subsidiaries were permitted to undertake certain prescribed types of business out of the province, including trust, insurance and deposit business, portfolio management and information services.

<sup>21</sup> That is, BC credit unions – whether operating in BC or elsewhere – are primarily regulated by BC, and other credit unions – whether operating in BC or elsewhere – are primarily regulated by their home jurisdiction (e.g., the province where the credit union is incorporated).

In 2010, the federal government changed from regulating insurance based on the “location of the insured risk or residence of the policyholder” to regulating based on the “location of the insurance business activities.” Because of concerns about consumer protection, BC adjusted its legislation to clarify that the insurance of property and persons situated in BC remains subject to provincial regulatory oversight, regardless of where the business activity (e.g., sale of the insurance product, underwriting, claims processing) is located. A variety of approaches are taken in other jurisdictions.

BC provided a specific exemption in 2008 to allow an unlicensed entity undertaking business outside the country to provide insurance to BC churches and organizations as part of a self-insurance program covering related member organizations in various jurisdictions, and other organizations have now requested similar exemptions.

While the insurance regulatory regime under the FIA is generally meant to ensure that consumers buying insurance are protected (e.g., insurers remain solvent, contracts are clear, insurance advisors are competent), it may be that those seeking to buy insurance offshore (e.g., multi-national corporations with property and risks in many countries) are sophisticated enough in financial matters that they do not need protection. However, there are also broader public policy objectives served by insurance regulation. For example, having insurance placed locally means that there are licensed insurers who can be more easily taken to court in BC in respect of claims by third parties (e.g., by a person injured on insured property). Broad exemptions for consumers purchasing insurance offshore could also impact the competitiveness of BC businesses.

It should also be noted that the FIA already provides a framework for licensed agents to place risk with unauthorized insurers where insurance is not otherwise available, and BC also has a flexible regulatory framework for self-insurance: captive insurers and reciprocal exchanges are permitted as regulated entities that organizations can use to reduce insurance costs and/or provide better claims management.

#### Related Issues:

##### *New Technology*

Issues related to new technology are generally discussed in the previous section. However, there may be additional issues related specifically to the use of technology by out of province entities (e.g., online sales by foreign companies to British Columbians). The current framework was developed prior to the development of online forms of business in the financial service sector.

#### Questions:

- 1) Are changes or clarifications needed to BC’s legislative framework for regulating extra-provincial credit unions, either for BC credit unions operating extra-provincially or for credit unions from other jurisdictions operating in BC?
- 2) Are changes needed to BC’s approach to insurance regulation? Should certain exemptions be available in respect of individuals and entities (including societies and self-insurers) seeking to purchase insurance outside BC? On what basis should exemptions be provided?

- 3) Are changes to the current legislative framework needed to address the use of technology by out of province entities providing financial products and services to British Columbians? Do the current definitions of what constitutes “carrying on business in BC” need to be revisited in light of increased e-commerce/online distribution of financial products?

## Issue 6: Regulatory Powers and Guidelines

FICOM supervises and regulates financial institutions (credit unions, insurers and trust companies) to determine whether they are in sound financial condition and complying with their governing laws (i.e., the FIA and CUIA) and supervisory standards. FICOM uses a risk-based supervisory framework. Risk assessment is forward-looking and facilitates the early identification of issues or problems, and timely intervention where corrective actions need to be taken, so that there is a greater likelihood of a satisfactory resolution of issues.

International regulatory standards, particularly with respect to governance, risk management and fair treatment of consumers, have evolved over time. International regulatory standards have increasingly focused on regulators having the appropriate regulatory tools to review and evaluate financial institutions, and their risks and governance, and the ability to intervene on a timely basis to address problems at an early stage. International standards recommend that laws, regulations and prudential standards be updated as needed to ensure they remain effective.

Guidelines issued by the regulator can be an important supervisory tool as they clarify supervisory expectations in relation to statutory provisions that are typically very technical in nature and allow for proactive and timely direction to financial institutions to address emerging risks. The use of guidelines can also help to ensure that prudential and market conduct standards are up-to-date and flexible so that standards remain effective and relevant to changing industry practices and structure.

Currently FICOM can – and does – issue guidelines/information bulletins. The guidelines do not replace legislative or regulatory requirements, but rather reflect what is in the legislation, clarify supervisory expectations, and inform supervisory assessments. The existence in BC of both regulations (e.g., the capital and liquidity requirements regulations) and additional supervisory guidelines may lead to uncertainty about what specific obligations apply to financial institutions.

### *Regulatory Powers of Similar Organizations*

The federal regulator, the Office of the Superintendent of Financial Institutions (OSFI), issues prudential guidelines intended to ensure compliance with the legal framework for federal financial institutions. While the guidelines themselves are not directly enforceable in law, they reflect and provide further clarification about the requirements set out in legislation, which are enforceable. In addition, as OSFI has sufficient tools to compel compliance, its guidelines are indirectly enforceable and are generally viewed by industry as equal to regulations.<sup>22</sup>

Some supervisory authorities have specific authority to issue legally binding regulatory guidance on prudential and, in some cases, business conduct requirements for financial institutions. This

<sup>22</sup> International Monetary Fund, *Canada Financial Sector Assessment Program: Intensity and Effectiveness of Federal Bank Supervision in Canada – Technical Note*, March 2014, pg. 8, <http://www.imf.org/external/pubs/ft/scr/2014/cr1470.pdf>.

guidance allows principles-based and risk-based expectations to be applied according to the risk profile, size, scope and complexity of the institution.

The Quebec regulator has the authority to issue both prudential and market conduct guidelines, after consultation with the Minister of Finance, and in some cases stakeholders, and uses this authority to issue a comprehensive set of guidelines governing most aspects of the regulation of financial institutions.<sup>23</sup> Under the legislation, failure to comply with the guidelines is deemed to be a failure of the institution to adhere to sound and prudent management practices and the regulator can issue binding compliance orders requiring an institution to remedy the situation.

The FIA does grant authority to the Insurance Council of British Columbia to make legally enforceable requirements or standards in the form of Council rules (e.g., rules respecting licensing, supervision, education, conduct, etc.). Similarly, the *Securities Act* provides the BCSC with the authority to make legally enforceable rules for some purposes (e.g., regulating trading in securities or exchange contracts). In both cases, the proposed rule must be published for public comment and the Minister of Finance can either consent or reject a proposed rule.

#### Related Issues:

##### *Winding Up of Entities*

The CUIA sets out the process by which FICOM can order that a credit union be wound up. To do this, the credit union must be under the supervision and administration of FICOM and its capital base must be less than a prescribed amount. Alternatively, FICOM can apply under the CUIA for a court ordered wind-up. Where a credit union is insolvent, FICOM as administrator of the credit union can bring an application under the federal *Winding up and Restructuring Act* (WURA). It is unclear whether FICOM would have standing under the WURA without being the administrator. Similar concerns arise with respect to insurance and trust companies.

The FIA and *Business Corporations Act* (BCA) set out the process for winding up an insurance or trust company. FICOM can only order wind-up where an insurance company has not obtained a business authorization after being incorporated. Otherwise, FICOM must bring an application under the BCA. If the company is insolvent, proceedings for winding up must be brought under the WURA. It is also unclear whether FICOM has the ability to intervene in a troubled institution's operations to help resolve issues and avoid proceeding to wind-up or liquidation.

##### *Role of the Financial Institutions Commission in Consenting to Major Transactions*

Financial institutions are required to seek written approval of the Commission for certain significant transactions, including amendments to the common bond, rule changes, business acquisitions and amalgamations. However, the FIA and CUIA do not set out clear criteria for the approval of major transactions. Additionally, major portfolio acquisitions or divestitures undertaken by financial institutions (e.g., acquisition or divestiture of an insurance, leasing or

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<sup>23</sup> *An Act respecting insurance*, R.S.Q., c. A-32, ss. 325.0.1 and 325.0.2; *An Act respecting trust companies and savings companies*, R.S.Q., c. S-29.01, s. 314.1; and *An Act respecting financial services cooperatives*, R.S.Q., c. C-67.3, s. 565.

venture capital subsidiary, or the purchase of a significant portfolio of business) do not currently require consent of the Commission.

*Regulation of Other Insurance Entities (including Reciprocal Exchanges, Mutual Insurers and Societies)*

The FIA includes regulatory frameworks for a number of entities other than insurance companies. Some of these frameworks are not as fulsome as the framework for regulating insurance companies. The frameworks for reciprocals and mutual insurers, along with BC captive insurance company legislation, provide important alternative options to insurance coverage in certain situations. Due to market changes, and regulatory developments in other jurisdictions, there may be a need to review whether the FIA provides an effective regulatory framework for reciprocals and mutual insurers.

With respect to societies offering insurance, the FIA includes a broad prohibition on any societies obtaining a business authorization to conduct insurance business. (The FIA has included this prohibition since its implementation in 1990, although a few existing societies already licensed under previous legislation were deemed to have a business authorization under the FIA, and other existing societies then offering limited types of coverage were provided with an exemption.) This approach has been in place for 25 years and it may be appropriate to review the effectiveness of the existing regulatory framework.

*Solvency Regulation of Insurers*

In Canada, provinces are responsible for market conduct regulation and both provincial and federal governments are responsible for solvency regulation, depending on where the company is incorporated. BC incorporated insurers are subject to provincial oversight for solvency and extra-provincial insurers authorized in BC are subject to solvency oversight by both the incorporating jurisdiction and BC (as a secondary regulator). Most insurance companies in BC are federally incorporated. Generally provincial regulators have harmonized their solvency standards with federal standards so that all insurers are subject to similar requirements regardless of where they are incorporated.

Questions:

- 1) Does FICOM have adequate tools to address current and emerging risks (at an individual and system-wide level) in a timely and effective manner?
- 2) Should FICOM have the ability (i.e., with authority provided in legislation) to issue enforceable prudential and market conduct requirements and standards/rules? If so, what limits on that power and accountability mechanisms are needed (e.g., oversight/approval role for government, appeal process, etc.)?
- 3) To respond to emerging risks in a timely manner, does FICOM need powers to revise conduct and solvency expectations outside of legislation or regulation? If so, what limits and accountability mechanisms are needed?
- 4) What major transactions should be subject to Commission approval? Should the FIA set out criteria for approval of major transactions?



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- 5) Do the FIA frameworks for reciprocals, mutual insurers and societies offering insurance need to be reviewed? If so, what issues need to be addressed?
- 6) Are any changes to solvency regulation of insurance companies in BC required?

## CREDIT UNION SECTOR

### Issue 1: Deposit Insurance

Deposit insurance contributes significantly to consumer confidence and market stability and is an important component of the financial system. There are a number of factors to take into consideration when determining the appropriate level and scope of deposit insurance coverage.

The International Association of Deposit Insurers (IADI) indicates that, while deposit insurance coverage was traditionally set to balance financial stability and depositor protection with incentives for depositors to exercise market discipline, the last two decades have shown that most depositors are unable to exercise effective market discipline and that low deposit insurance coverage limits can undermine financial stability because “most depositors, if not adequately protected, will indiscriminately run from both sound and weak banks.”<sup>24</sup> IADI indicates that a different view of deposit insurance coverage is emerging in which “the predominant function of coverage is to promote confidence, financial stability and prevent chaotic depositor runs.”<sup>25</sup>

Recently, international regulatory organizations have begun to caution against unlimited deposit insurance because of the potential incentive for increased risk-taking by financial institutions. The Basel Committee on Banking Supervision and IADI released a set of core principles which address all aspects of deposit insurance.<sup>26</sup> They recommend that deposit insurance adequately cover a large majority of depositors and that the level of coverage be limited but credible. They also recommend that jurisdictions with unlimited deposit insurance transition to limited coverage as soon as their circumstances permit, with careful planning of the transition due to the importance of deposit insurance in maintaining public confidence. Jurisdictions have generally reintroduced limits on coverage only where financial market and general economic stability have been achieved and the change is unlikely to impact public confidence in financial institutions.

In 2008, in response to the global financial crisis, the BC government implemented unlimited deposit insurance coverage for deposits held by BC credit unions (the previous limit was \$100,000).<sup>27</sup> One of the reasons for this change was to bring coverage in line with Alberta, Saskatchewan and Manitoba, all of whom provide unlimited deposit insurance (BC provides a

<sup>24</sup> International Association of Deposit Insurers, *Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage*, March 2013, pgs. 7-8, [http://www.iadi.org/docs/IADI\\_Coverage\\_Enhanced\\_Guidance\\_Paper.pdf](http://www.iadi.org/docs/IADI_Coverage_Enhanced_Guidance_Paper.pdf).

<sup>25</sup> Ibid.

<sup>26</sup> Basel Committee on Banking Supervision and International Association of Deposit Insurers, *Core Principles for Effective Deposit Insurance Systems*, June 2009, <http://www.bis.org/publ/bcbs156.pdf>.

<sup>27</sup> All money on deposit and money invested in non-equity shares with a BC credit union, regardless of whether it is placed directly with the credit union or through a broker, is 100 percent guaranteed by CUDIC (a statutory corporation of the BC government administered by FICOM). Personal and business accounts that are guaranteed include: savings accounts; chequing accounts; joint accounts; trust accounts; term deposits (with no limit on the length of the term to maturity); GICs (that are in the form of money on deposit with a BC credit union); foreign currency deposits; registered and tax-free savings accounts. Accrued interest on deposits is also guaranteed. With the exception of Stabilization Central and Central 1, all BC credit unions are covered. Credit union equity shares and investments such as mutual funds or RRSP equity plans are not covered by deposit insurance.

higher level of deposit coverage than federally regulated Canadian banks and credit unions in central and eastern Canada). While the vast majority of BC credit union members hold deposits of less than \$100,000, there are a significant number of individual members who have deposits above that amount (e.g., those selling their home or with registered retirement savings of more than \$100,000 held with one institution). In addition, larger deposits are an important source of funds for credit unions' lending activities (e.g., mortgage lending).

Related Issues:

*Additional Special Coverages*

If limits on deposit insurance coverage were to be reintroduced, consideration may need to be given to exceptions. While limited deposit insurance coverage usually applies to all accounts held by an individual with one financial institution (i.e., the individual is covered for \$100,000 in total, not \$100,000 for each separate account they hold), most jurisdictions in Canada provide exceptions such as separate coverage or protection for joint deposit and retirement savings accounts – that is, a joint account or retirement savings account may have coverage that is in addition to the coverage for an individual's other accounts. Some provinces – Ontario and Prince Edward Island – provide unlimited deposit insurance protection for all registered retirement savings products held with credit unions. Consideration may also need to be given to coverage for public sector deposits (e.g., municipalities, schools, universities/colleges, hospitals).

*Net vs. Gross Payout*

A gross deposit insurance payout would be based solely on the amount of the deposit itself and a net deposit insurance payout would subtract any loans owing to the institution from the payout amount. International standards favour gross deposit insurance payouts and deposit insurance protection available in respect of Canadian banks is on a gross basis. This allows for clearer and faster settlement, although the gross payout basis also expands the obligations of the deposit insurer. The FIA expressly provides CUDIC with the authority, but not the obligation, to proceed with payouts on a net basis. Reviewing the FIA payout rules in light of international standards may be appropriate.

*Potential Limitations on Coverage*

*Foreign currency:* BC provides coverage for foreign currency deposits which can create particular risks for deposit insurers and significantly increase the cost of a deposit insurance payout. This coverage is not provided for federal banks.

*Term deposits:* BC and several other jurisdictions (Alberta, Manitoba and Ontario) provide protection for any demand or term deposit, while Quebec, New Brunswick, Prince Edward Island and Newfoundland match federal deposit insurance and only provide coverage for term deposits up to five years.

*Interbank deposits:* Many jurisdictions do not offer protection for deposits of other financial institutions, although Australia, Canada and the United States do provide coverage for one bank depositing in another. In addition, BC credit unions do not have any restrictions on institutional and brokered deposits, either from within the province or from other jurisdictions.

Questions:

- 1) What is the optimal and appropriate level and system of deposit insurance?
- 2) Should a limit on deposit insurance protection be reintroduced, and if so, what limit? Should any limits be reviewed on a regular basis (e.g., every five or ten years)?
- 3) If a limit was reintroduced, should certain exceptions be made (e.g., unlimited protection for registered retirement savings products), similar to what has been done in other jurisdictions?
- 4) Are other reforms to BC deposit insurance coverage needed? Is the scope of coverage appropriate (i.e., should certain products or types of deposit be excluded or included)?

**Issue 2: Credit Union Governance**

*Director Suitability and Board Composition*

The basic governance framework for credit unions is set out in the CUIA, supplemented by rules in the FIA. The legislation imposes requirements with respect to directors (e.g., minimum numbers, residency requirements, certain prohibitions, requirement for training), and FICOM has the discretion to remove directors and officers that have been convicted of certain offences, have conflicts of interest or are otherwise unsuitable.

The CUIA is primarily based on the older *Company Act* corporate law framework, with modifications to reflect cooperative law principles. The business corporate law framework generally has been significantly updated and, as the credit union sector becomes increasingly sophisticated and credit union boards face greater governance responsibilities, the regulatory and corporate governance framework for credit unions may also need to be updated.

The effectiveness of a board is based on its ability to set appropriate strategic plans, oversee management and understand business risks, and its accountability and transparency to its members. FICOM has issued a guideline that outlines expectations for governance practices at BC credit unions.<sup>28</sup> Areas of focus include the role of the board, the board's relationship with FICOM, and the board's role in strategic planning and performance, risk governance, and accountability and disclosure. The guideline also requires each director to be financially literate, as demonstrated by their ability to understand the relationship between the credit union's strategic plan and financial outcomes.

*Member Engagement*

Under cooperative law principles, credit union members are expected to be engaged in significant operational or strategic changes. However, both credit unions and their members have expressed some frustration with the current framework for member proposals, meeting requisitions and overall member engagement. Credit unions have expressed concern that the current thresholds for initiating member proposals are too low, impede decision making, add

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<sup>28</sup> Financial Institutions Commission, *Governance Guideline*, September 2013, <http://www.fic.gov.BC.ca/pdf/creditUnionsTrusts/GovernanceGuidelineCUs.pdf>.

costs, and require credit unions to expend resources on what may be the interests of very few members.

Members have expressed concern about the lack of opportunity/ability to provide meaningful input into significant changes being contemplated by the credit union (e.g., mergers and acquisitions, branch closures, discontinuation of services, geographic expansions, board compensation, and common bond). In some cases, further information beyond what is mandated in the CUIA has been requested by members. There is increased interest in the decision making process undertaken by credit unions to pursue mergers by amalgamation and business acquisitions by asset transfer (currently members of all credit unions have the right to vote on an amalgamation, but only members of the credit union being acquired have the right to vote on an acquisition).

### *Voting*

Currently, the CUIA establishes the basic framework for voting and meetings, including the “one member, one vote” principle and the prohibition on proxy voting of membership shares. In practice, most requirements around who is eligible to vote and director elections are determined by individual credit unions.

Some credit unions and members have expressed a desire to improve the voting process for election of directors and other special resolutions to increase participation, and some members have expressed concern about credit unions’ endorsement of board candidates (and other motions) and about ballots being confusing.

### Related Issues:

#### *Common Bond Requirement*

Historically, credit union membership was defined by a common bond. The CUIA sets out the different types of credit union common bond. As credit unions continue to grow and enter new markets, some credit unions have questioned the relevance of requiring a common bond.

### Questions:

- 1) Are changes to the credit union governance framework needed?
- 2) Are changes needed to foster member engagement and/or deter frivolous proposals? If so, what changes are needed? How can member engagement be increased?
- 3) Do CUIA rules on mergers and acquisitions provide appropriate disclosure and approval mechanisms?
- 4) Are changes to the voting process for election of directors and other special resolutions needed? Should there be more clarity around endorsement of nominees or proposals by a credit union? Should member thresholds and other voting processes be in legislation or credit union rules?
- 5) Should credit unions be required to have a common bond? Should the criteria for what can be a common bond be changed?

### Issue 3: Capital Requirements

Capital adequacy requirements set out the amount of capital a financial institution has to hold. Holding capital helps a financial institution ensure it has the financial resources to operate successfully and, if not, helps to ensure the firm’s depositors and creditors do not incur losses by enabling repayment of the amounts/investment they are owed.

Historically, capital requirements were simply a fixed dollar amount of initial investment by shareholders. In 1988, the Basel Committee on Banking Supervision established an international risk-based capital adequacy framework for deposit-taking institutions (Basel I) which required an institution to hold sufficient capital to support its particular business activities (i.e., a financial institution with riskier investment and lending must hold proportionately more capital). BC was one of the first adopters of Basel I (through the FIA).

Over the past two decades, international standards for financial sector regulation have evolved by increasing regulation to promote stability in the financial system, in particular by addressing regulatory weaknesses revealed during the 2008 financial crisis. The Basel Committee developed enhanced standards: Basel II and then Basel III, which was developed in light of the financial crisis and increases capital standards and strengthens supervisory and disclosure requirements.<sup>29</sup> In Canada, the federal regulator, OSFI, has moved to adopt the Basel III framework through guidelines for all federal deposit-taking institutions. Work is continuing nationally and internationally and further reforms are likely to be developed (e.g., a Basel IV).

Currently, some provinces have credit union capital requirements based on Basel I or II, and others are in the process of implementing elements of Basel III. BC’s legislative framework is still primarily based on Basel I. The Credit Union Prudential Supervisors Association, an interprovincial association composed of credit union deposit insurers and prudential supervisors across Canada that works toward maintaining a sound and sustainable credit union sector through joint actions, has supported the adoption of international capital standards across Canada. In Quebec, the Desjardins Group complies with Basel III rules, but individual *caisses populaires* (which are all small, local institutions) are not subject to the new standards. The Ontario government has commenced a review of its credit union legislation, and one of the issues it is consulting about is whether to update its capital requirements framework, and specifically whether to adopt Basel III standards.

The credit union system in BC has grown significantly since the current (Basel I based) capital requirements were introduced. Growth, consolidation and increased interconnectivity in the sector have resulted in greater complexity of operations and a greater concentration of assets into a few large credit unions. While credit unions in BC delivered strong financial results and remained stable during the financial crisis and in subsequent years, credit unions are operating in an environment with increasingly complex risks. Failure to benchmark the latest standards in BC could reduce confidence in the regulatory oversight of credit unions and in the credit union system itself.<sup>30</sup> Failure to apply similar standards among all financial institutions operating in

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<sup>29</sup>Basel Committee on Banking Supervision, *International regulatory framework for banks (Basel III)*, <http://www.bis.org/bcbs/basel3.htm>.

<sup>30</sup> Since 2004, BC has directly applied federal (essentially international) insurance capital standards to provincial insurers.



the same marketplace can also lead to more risky investments gravitating to one tier of participants.

It is important, however, to balance financial stability considerations with the cost that increased regulation would impose, as overly onerous requirements could impact the competitiveness of BC credit unions and have a negative impact on financial sector innovation. The particular circumstances of the BC credit union system also need to be taken into account – while credit unions do provide many of the same products and services as banks, they are different, and the size of credit unions varies greatly, both within the BC system and in comparison to banks.

Related Issues:

*Commercial Lending*

Business loans often have higher rates of return than personal loans, and a balanced portfolio of personal and commercial lending can help diversify the assets of a credit union. Under the FIA, credit unions are not prohibited from entering into commercial loans, but the capital required in respect of the loan may be higher (i.e., double risk weighting applicable to commercial loans above the 30 percent threshold).<sup>31</sup> This special risk weighting requirement is not imposed under the Basel standards and is not imposed on Canadian banks. In addition, it does not take into account the complexity or nature of a particular loan.

Double risk weighting was adopted in BC in recognition that commercial lending is particularly risky for regional financial institutions (like credit unions) that invest in regional economies. In the United States, there is evidence that many regional bank failures have resulted directly from commercial real estate losses. Experience with failures of deposit-taking institutions in Canada, while very rare, has also shown that commercial loan losses, particularly when concentrated in specific regions, can be a major factor in failures.

*Share Capital*

Credit unions have, in practice, limited means to raise capital and capital growth is primarily achieved by retaining and reinvesting profits. While BC credit union legislation does permit credit unions to issue various classes of equity shares and other securities, this has rarely been done.

A further issue relates to the CUIA rules respecting redemption of membership and other equity shares when members withdraw their membership. This redemption reflects basic cooperative principles, but means that credit union shares may not meet the “permanency of capital” requirements set out in Basel III. The standards recognize that some flexibility should be provided to mutual or cooperative financial institutions, and consideration could be given to legislative reforms to enhance the permanency of this capital for regulatory purposes while still reflecting cooperative principles.

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<sup>31</sup> The Capital Requirements Regulation provides that where the aggregate value of a credit union’s commercial loans and leases exceeds 30 percent of the value of the credit union’s assets, an additional weighting factor (effectively doubling the capital requirements) shall be applied for the proportion of value exceeding 30 percent.

Questions:

- 1) Is BC's current capital framework for credit unions adequate or are changes needed?
- 2) Should BC's capital requirements benchmark national and international capital standards and be more principles/risk-based? Should different capital standards be applied depending on the size and complexity of financial institutions?
- 3) Are there issues with the commercial lending threshold, and should it be re-evaluated? Should BC consider adopting a more risk sensitive approach to commercial loans (i.e., rather than assigning all commercial lending a 100 percent risk weighting)?
- 4) Credit unions have less access to capital markets and may be at a disadvantage compared to other financial institutions when it comes to raising capital. Are there other innovative capital instruments available to credit unions that are not contemplated under BC's current framework and, if so, should they be?
- 5) Do the CUIA rules on membership and equity share redemption need to be revised?

#### Issue 4: Liquidity Requirements

Deposit-taking institutions generally face a mismatch between their investments and their obligations to depositors, as their investments are often locked into longer term assets such as mortgage loans whereas they are required to pay out money to depositors on demand. Liquidity regulation is intended to help ensure that financial institutions maintain a cushion of readily available funds (cash or other assets easily convertible to cash) to respond to changes in customer demands, such as an unusually high level of withdrawals. Maintaining consumer confidence in an institution’s ability to pay out deposits when demanded is vital.

Credit unions are required under the FIA to hold liquidity reserves equal to 8 percent of their deposits and other debt liabilities. Most credit unions must hold all required liquidity with Central 1.<sup>32</sup> Large credit unions (those with assets over a certain size) must hold a significant portion of their required liquidity reserves in deposits with Central 1, with the remainder held in other prescribed types of liquid assets (i.e., cash, deposits in banks, treasury bills, etc.).<sup>33</sup>

When adopted in September 1990, the regulations required a higher level of liquidity deposits to be held in Central 1 (10 percent) but this amount was reduced in 2004 to the current 8 percent requirement, benchmarking rules applicable to credit unions in other Canadian jurisdictions. Since the adoption of the liquidity requirement in 1990, no BC credit union has drawn on its statutory liquidity. The FIA also provides that “whether or not the financial institution is complying with the regulations,” FICOM may order the financial institution to acquire additional liquid assets if FICOM considers that the liquid assets of a financial institution are, or will be within one year, inadequate in relation to the business carried on by it.

The regulatory frameworks in other provinces include direction on how liquidity funds must be held by centrals and allow for regulations in areas such as the return that a central must provide to credit unions depositing their funds. The BC legislative framework does have broad regulation making power respecting the adequacy of liquid assets, but no regulations have been prescribed setting out the details of the liquidity deposits framework (e.g., what types of pooling arrangements and investments should be permitted).

The last financial crisis exposed weaknesses in the liquidity regulation and risk management of financial institutions as a number of institutions around the world experienced stresses to their liquidity. To address that issue, one of the key features of the Basel III standards is the introduction of a principles-based approach to liquidity management, with a focus on high quality liquid assets.<sup>34</sup> A number of supervisory tools have been developed to monitor liquidity and replace the use of prescribed metrics often outlined in regulation.

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<sup>32</sup> This requirement applies to credit unions where 8 percent of their deposits and other debt liabilities represents less than 1.5 percent of total credit union system assets.

<sup>33</sup> The largest credit unions must each hold an amount equal to at least 1.5 percent of total credit union system assets with Central 1, with the balance of the required 8 percent held in other prescribed types of liquid assets.

<sup>34</sup> Two new liquidity standards for supervisory purposes were developed: the liquidity coverage ratio which focuses on short term liquidity (the financial institution’s liquidity over a period of a month) and the net stable funding ratio which takes a longer perspective (up to a 12 month time horizon).

Questions:

- 1) Are the current legislated liquidity requirements for credit unions appropriate or are changes needed? If so, what changes?
- 2) Should BC's liquidity requirements reflect national and international liquidity standards and be more principles/risk-based? Should different standards and rules be applied depending on the size and complexity of financial institutions?

**Issue 5: Responsibility and Regulation of Central Credit Unions**

Central credit unions – Stabilization Central Credit Union and Central 1 Credit Union – are critical components of the BC credit union system.

The role of Stabilization Central is to identify and assist credit unions facing governance, operational or financial challenges and to manage a stabilization fund that can be used to help credit unions experiencing difficulties meet supervisory expectations. Stabilization Central works closely with FICOM where needed to assist troubled and distressed credit unions.

Central 1's key legislated role is as the BC credit union system's liquidity provider. All BC credit unions are required to be members of Central 1 and hold statutory liquidity with Central 1.<sup>35</sup> In addition to its statutorily defined role as liquidity provider, Central 1 has other roles and responsibilities: it provides liquidity support to Ontario credit unions; acts as the Canadian credit union system's primary payments provider (outside of Quebec); and acts as a trade association providing services to its credit union members.

Central 1 is currently jointly regulated by BC (FICOM) and federal (OSFI) regulators. In October 2014, the federal government tabled legislation (Bill C-43) which proposed that the federal government cease supervising all provincially regulated central credit unions, including Central 1. The federal government indicated that there would be a two year transition period to allow credit unions and provinces to prepare for sole oversight of their respective centrals. Bill C-43 received Royal Assent in December 2014, and the federal government has now fixed the coming into force date for the provision related to the withdrawal of OSFI supervision of provincial credit union centrals as January 15, 2017.<sup>36,37</sup> Bill C-43 also clarifies the Bank of Canada's current policy that any emergency liquidity support provided through a central credit union will have to be backed by a provincial government guarantee.

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<sup>35</sup> FICOM has identified Central 1 as a "Domestic Systemically Important Financial Institution" (D-SIFI) due to its essential role. D-SIFIs are financial institutions whose disorderly failure could cause significant disruption to the wider financial system and economic activity. As a result, Central 1 is subject to additional capital and liquidity requirements and enhanced supervision by FICOM.

<sup>36</sup> Government of Canada, *Economic Action Plan 2014 Act, No. 2*, <http://www.parl.gc.ca/LegisInfo/BillDetails.aspx?Language=E&Mode=1&billId=6732518>.

<sup>37</sup> Government of Canada, Privy Council Office, <http://www.pco-bcp.gc.ca/oic-ddc.asp?lang=eng&Page=&txtOICID=&txtFromDate=&txtToDate=&txtPrecis=Economic+Action+Plan&txtDepartment=&txtAct=&txtChapterNo=&txtChapterYear=&txtBillNo=&rdoComingIntoForce=&DoSearch=Search+%2F+List&viewattach=30767&blnDisplayFlg=1>.

FICOM will become the sole prudential regulator of Central 1 and, accordingly, the sole prudential regulator of the primary payments and clearing provider for Canadian credit unions (outside Quebec). The rules in the CUIA and FIA were not developed in contemplation of FICOM regulating a central credit union whose role has expanded beyond the traditional business of a provincial central credit union, and the FIA did not contemplate Central 1 having an expanded role as the credit union system's payments and clearing provider and supporting credit unions outside the province.

Questions:

- 1) Are changes or clarifications to Stabilization Central's mandate/role, powers or corporate governance structure needed?
- 2) Are changes or clarifications to Central 1's mandate/role, powers or corporate governance structure needed?
- 3) Are any changes needed in light of the removal of federal oversight and regulation of central credit unions?

## **INSURANCE SECTOR**

### **Issue 1: Insurance Retailing and Licensing Exemptions**

Insurance products are generally sold by licensed agents who provide advice and help consumers to understand products. Licensed agents who fail to comply with requirements under the FIA, or those set out in Insurance Council rules, may face disciplinary action.

However, the FIA provides a number of exemptions from the requirement that insurance be sold by a licensed agent. These exemptions generally relate to insurance to cover a good or service the consumer is acquiring from the seller (e.g., where credit insurance is sold incidentally to the arranging of credit by a financial institution). The assumption is that the exempted seller will act in a good faith manner with regard to the insurance because he wishes to maintain the business relationship with the consumer, although this may not always be the case as the exemptions are fairly broad and also allow for incidental sales where the relationship is a one-time transaction (e.g., a travel agent selling travel insurance for a trip).

While some exempted sellers receive training, and may in some cases be highly trained, exempt sellers usually have no mandatory education requirements and may not have the same knowledge of products that a licensed insurance agent or broker would have. Exempt sellers are also generally not under the direct oversight of the insurer and often are not accountable to regulatory bodies.

Some provinces (e.g., Alberta, Saskatchewan and Manitoba) allow certain entities, such as motor vehicle dealers and financial institutions, to obtain a restricted insurance agent licence which allows them to sell insurance where it is sold incidentally to their ordinary business. The licence is typically a corporate licence issued to the dealer or financial institution which holds the corporate licensee responsible for the insurance activities of its employees.

Travel agencies in British Columbia that sell travel insurance operate on a restricted insurance agent model, whereby the travel agency obtains a licence that allows travel agents to sell travel insurance if they have met education requirements.

#### **Questions:**

- 1) Are the current exemptions appropriate? Should any additional exemptions be provided?
- 2) Should insurers have more responsibility for exempt sellers? Should they be required to provide more direct oversight?
- 3) Should the FIA be amended to give the Insurance Council increased powers to license and regulate incidental sellers of insurance?
- 4) Should certain insurance products only be sold by licensed agents? If so, which ones?
- 5) Should the restricted insurance agent model used by some other provinces, and applicable to travel agencies in BC, be looked at with respect to the sale of other types of incidental insurance such as credit insurance and/or product and vehicle warranties? If so, which types?



- 6) Is the current restricted licensing regime for travel agencies effective and appropriate? Should travel agents, who are already regulated by Consumer Protection BC, be provided with an exemption under the FIA?

## Issue 2: Regulation of Insurance Intermediaries

The Insurance Council of British Columbia is established under the FIA and its mandate is to provide a robust level of protection to the public respecting the sale of insurance products and services by licensed insurance agents. The Insurance Council has the power to conduct investigations and to discipline licensees when warranted, and is also responsible for regulation of licensed insurance adjusters.

In 2004, the FIA was amended to give the Insurance Council authority to adopt rules respecting licensing, supervision, nominees, education, codes of conduct, licensing conditions, procedures respecting disciplinary hearings and suspensions, and maximum fees for licensing. The Insurance Council consists of eleven voting members appointed by the Lieutenant Governor in Council.<sup>38</sup> The Minister of Finance may also appoint an unlimited number of non-voting members.

Like BC, a number of other provinces have both a financial institutions commission or regulator and an insurance council (or several councils/similar bodies) acting as an intermediary regulator.<sup>39</sup> However, while all Insurance Council members are appointed by government in BC, councils in some other provinces have members elected by industry (e.g., agents, brokers, etc.) or appointed by major industry associations such as the Canadian Life & Health Insurance Association and the Insurance Bureau of Canada. Most BC professional self-regulatory bodies in other industries have elected members, or a mix of elected and appointed members.

### Related Issues:

#### *Accountability Framework*

Although members are appointed by government, the Insurance Council is essentially a self-regulatory organization (SRO). Concerns are sometimes raised about self-regulation, including that SROs may have an incentive to protect industry members rather than the public and that they may unfairly limit competition by barring new entrants.

However, there are accountability frameworks, including the one to oversee the Insurance Council, which are designed to ensure that the public is appropriately protected. For example,

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<sup>38</sup> The FIA requires that voting members be: two agents or salespersons licensed in at least one class of general insurance; two agents licensed in respect of life insurance; two officers or employees of insurers authorized in respect of life insurance plus two from general insurers; one licensed insurance adjuster; and two members at large.

<sup>39</sup> For example, Alberta has four insurance councils: the Alberta Insurance Council (which looks after the financial matters of the councils and provides investigative and administrative services to them); the Insurance Adjusters' Council; the General Insurance Council; and the Life Insurance Council.

disciplinary decisions of the Insurance Council and refusals to issue a licence must be in writing, are subject to a hearing requirement, and may be appealed to the Financial Services Tribunal.<sup>40</sup>

It is also important to note that FICOM continues to oversee the broader insurance market and supervise insurance companies, and to have jurisdiction over insurance intermediary regulation in certain respects. The Insurance Council's authority only extends to licensees (and in some cases former licensees) and responsibility respecting all unlicensed activity falls to FICOM.

### *Special Brokers*

In BC, special brokers – agents who place contracts of insurance with unlicensed insurers – are subject to both requirements imposed by the Insurance Council and government regulations requiring specific reporting to FICOM. However, in several other provinces these brokers are licensed directly by the financial institutions regulator or government, not by the insurance council, as this business involves heightened consumer and regulatory risk. Often these insurance contracts cover risks that are unique and cannot be placed with a licensed insurer in the province.

### *Access to Insurance Adjusters from Other Provinces*

The insurance intermediary framework also provides for the regulation of insurance adjusters. Concerns have been raised regarding impediments to cross-jurisdictional licensing and access to adjusters from another province (e.g., concerns about the ability to utilize additional adjusters from other provinces in the event of a large scale natural disaster).

### Questions:

- 1) Should some or all members of the Insurance Council of BC be elected?
- 2) Does the Insurance Council have the right regulatory tools and structure for its role? Are any improvements needed to enhance coordination between the supervisory and intermediary regulatory authorities?
- 3) Is the current oversight framework, including appeals to the Financial Services Tribunal, effective? If Insurance Council members are elected, are changes needed to other aspects of the accountability framework?
- 4) Should special brokers in BC be required to obtain licences directly from FICOM?
- 5) Are changes needed to the licensing framework for insurance adjusters?

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<sup>40</sup> The Financial Services Tribunal was established in 2004 under the FIA and consists of members appointed by the Lieutenant Governor in Council. The tribunal hears appeals from individuals and institutions who want to contest enforcement decisions made by the Superintendent of Financial Institutions, the Superintendent of Real Estate, the Superintendent of Pensions, and the Registrar of Mortgage Brokers, as well as the Real Estate Council and Insurance Council of BC. It provides an avenue of appeal for resolving disputes between financial sector regulators and those they regulate.

### Issue 3: Protection of Confidential Information

Risk-based regulatory models rely on companies implementing a self-assessment system that identifies risk and reports compliance to the regulator. To regulate effectively, regulators need adequate information from regulated entities. In addition, cooperation and sharing of information among financial sector regulators is important for effective oversight of financial institutions which operate in multiple jurisdictions and/or where there is overlapping regulatory authority.

Regulated entities also want to be certain that information supplied in confidence to regulatory authorities will be appropriately protected. Concerns have been raised that information provided in relation to regulation under the FIA may not be adequately protected. This may impact the quality and timeliness of disclosure and, consequently, the ability of the regulator to protect the public interest.

#### *Insurer Self-Assessment Privilege*

Insurers have expressed concern that self-assessments prepared by insurers for internal risk management and/or provided to regulators may provide evidence for plaintiffs in legal proceedings. The concept of privilege arises when another public purpose (e.g., solicitor-client privilege respecting the ability of a person to obtain legal advice in confidence) outweighs the importance of the courts having all relevant information. In May 2008, the Canadian Council of Insurance Regulators recommended implementation of privilege for insurance compliance self-assessment documents and indicated that: “regulators have been told by insurers that the potential for litigants to access the results of insurer self-assessments of their operations is a disincentive to full and open disclosure in self-assessments.”<sup>41</sup>

Insurers believe that self-assessment privilege will result in more thorough and honest self-assessments, which will lead to more effective internal trouble-shooting, fewer consumer complaints, greater openness with regulators about potential problems, and quicker resolution of issues. The Canadian Bar Association, however, has argued that insurer self-assessment privilege would prevent insurance customers who sue their insurance company from obtaining relevant information, and that it is inconsistent with insurance companies’ duties of good faith and fair dealing.

In November 2008, Alberta became the first Canadian jurisdiction to provide privilege for the self-assessment programs of insurance companies. Alberta’s *Insurance Act* contains provisions protecting from disclosure any document prepared in connection with an “insurance compliance self-evaluative audit.”<sup>42</sup> Manitoba recently adopted similar provisions, and a number of states in the United States also have privilege provisions for insurers.

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<sup>41</sup> Canadian Council of Insurance Regulators, *Final Report on Privilege Model and Whistle Blower Protection*, pg. 7, [http://www.ccir-crra.org/en/init/Privilege/Final\\_Report\\_on\\_Privilege\\_Model\\_July08.pdf](http://www.ccir-crra.org/en/init/Privilege/Final_Report_on_Privilege_Model_July08.pdf).

<sup>42</sup> “Insurance compliance self-evaluative audit” for purposes of Alberta’s *Insurance Act* means “an evaluation, review, assessment, audit, inspection or investigation conducted by or on behalf of a licensed insurer or fraternal society, either voluntarily or at the request of the Minister or the Superintendent, for the purpose of identifying or preventing non-compliance with, or promoting compliance with or adherence to, statutes, regulations, guidelines or industry, company or professional standards.”

In BC, the FIA contains a confidentiality provision that applies to information submitted to the regulator. It states that information submitted in accordance with the FIA cannot be disclosed for purposes other than administering the Act except for prosecution or as required by law. This provision does not protect any documents or information retained by the insurer.

### *Freedom of Information*

One of the goals the *Freedom of Information and Protection of Privacy Act* (FOIPPA) is to make government more accountable to the public by giving the public a right of access to records. FOIPPA permits government to refuse to disclose information received confidentially from a third party, but requires a finding that the disclosure of the confidential information would “significantly harm the competitive position” of the third party providing the information. The few disclosure decisions by BC’s Information and Privacy Commissioner relating to financial sector information have suggested that the discretion available to FICOM to refuse to disclose information received in confidence is limited.

Concerns about the protection of information are also relevant to cooperation and sharing of information among regulators. Other regulators such as the federal regulator, OSFI, with whom FICOM must cooperate in the regulation of financial institutions operating in BC, may be reluctant to share information with FICOM because information protected in their jurisdiction may be released in BC.

Legislation in other jurisdictions provides for greater protection of confidential financial services information. For example, the federal financial institutions regulator may withhold information under the federal *Access to Information Act* where the information is supplied in confidence; there is no obligation to prove significant harm. Alberta’s *Insurance Act* provides strict rules on the protection of insurer information (information the government obtains or creates for the purpose of administering or enforcing the legislation) and expressly states that the Alberta freedom of information legislation does not apply to insurer information. The legislation also prohibits disclosure of information received from other governments or regulatory bodies without their consent.

### *Disclosure of Confidential Information Held by FICOM in Court Proceedings*

As noted above, the FIA provides for disclosure of regulatory information “as required by law,” including under a court order respecting disclosure of documents relevant to a legal proceeding against an insurer. Recent court decisions have concluded that a statutory promise of confidentiality does not rule out the production of documents and information in court proceedings.

### Questions:

- 1) Does BC’s financial institutions legislation achieve the right balance between open government and appropriate protection of confidential information relating to financial institutions? If not, what changes are appropriate?
- 2) Would insurer self-assessment privilege provide a net public benefit by enhancing internal compliance systems and confidential disclosure to the regulator? Do the benefits outweigh the costs of limiting evidence available in court proceedings?

- 3) Should the issue of privilege be addressed in the context of insurers alone, financial institutions generally or through a more comprehensive review related to all industries?

#### **Issue 4: Long-term Disability Plans**

The provision of long-term disability (LTD) benefits by an employer is optional, and employers (and other benefit plan sponsors) in BC are not required to insure their LTD benefit plans.

LTD plans insured by a licensed insurance company are regulated as an insurance product, and require reserve funds to be established and the insurance provider to hold regulatory capital in relation to the plans, so insured benefits will continue to be paid even if the employer becomes bankrupt. However, LTD benefit plans managed directly by the employer are not subject to regulation. In those plans, the employer generally pays benefits from cash reserves or existing cash flows, so benefits are only paid if the employer remains solvent (i.e., does not go bankrupt). As a result, there are significant differences in the risk profiles of insured LTD plans and plans managed by employers.

BC requires that employers disclose to employees that an LTD plan is not insured and not subject to the regulatory requirements of the FIA. The intent is to create awareness of the risks of an employer managed plan, so the employee could choose to purchase further protection from a licensed insurer if desired. However, it is not clear that consumers/employees are aware of the risks. Notification is usually made at the start of employment and the implications may not be fully understood.

In addition, some employers contract a third party insurance company to administer their direct benefits under an Administrative Services Only (ASO) plan, where the insurance company adjudicates claims and administers benefits on behalf of the employer. This could create the misperception that the employer managed benefit is a product offered by the insurance company, with the expectation that the benefit would survive an employer bankruptcy.

The federal and Ontario governments require LTD benefit plans to be insured to protect these benefits if an employer becomes insolvent.

#### Questions:

- 1) Does BC have the right approach to long term disability benefits?
- 2) Should employers and other plan sponsors be required to insure LTD benefit plans? Would this deter employers from providing these benefits?
- 3) Are there consumer protection issues related to ASO plans? How can consumer awareness be increased?

## Issue 5: Rebating

Rebating refers to the practice of giving money or other items of value to a customer to induce the sale of an insurance product. The FIA formerly had a very broad prohibition on rebating for insurance products, and during the previous review of the FIA it was proposed that the prohibition be eliminated entirely.

At that time, financial institutions generally indicated that the prohibition was unnecessary and a hindrance to competition and product development. However, insurance brokers and other intermediaries indicated that they viewed it as a critical consumer protection provision, because allowing rebates of a substantial amount of the premium could pressure sales agents to engage in the practice and affect service quality. Ultimately, the legislation was amended to eliminate the blanket prohibition and allow rebating up to a prescribed maximum of 25 percent of the value of the premium.

Financial institutions have expressed concern that observing and enforcing this limit imposes unnecessary costs on both industry and the regulator. However, property and casualty (P&C) insurance brokers continue to raise concerns that the current rebate level has negative impacts on the quality of insurance products. They indicate that, while 25 percent may be an appropriate amount in respect of life insurance where a significant amount or all of the first year's premium may be paid to the agent, it is not an appropriate threshold in respect of P&C insurance as P&C brokers rarely receive a commission as large as 25 percent of the premium.

### Related Issues:

#### *Third Party Payments*

In addition to any rebating to customers, payments can be made to third parties. While commissions or compensation may not be paid to persons acting as an insurance agent unless they are licensed, insurance agents may pay fees to persons whose only action is to refer a client to the agent. The FIA requires an insurance agent to disclose to a customer that compensation has been paid for the referral, but does not require the amount of the payment to be disclosed.

Concerns have been raised that strata managers have been seeking payments for insurance referrals respecting strata properties they manage and, in particular, that payments are being made without any notice to the strata corporations. The Insurance Council issued a notice in 2011 reminding agents of their obligation to inform the client, namely the strata corporation purchasing the insurance, of any referral payments being made.

### Questions:

- 1) Is the current FIA rebating framework effective and appropriate?
- 2) Is the threshold of 25 percent of the premium appropriate? Would a different level be more appropriate, and if so, what level?
- 3) Are the current disclosure rules on referral payments adequate to protect consumers? Should agents also be required to disclose the amount of any referral payment?



## **TRUST SECTOR**

### **Issue 1: Regulatory Framework for Trust Companies**

Historically, Canada’s financial services sector was separated into four distinct pillars: chartered banks; insurance companies; trust companies; and investment dealers. Changes to the legal framework and marketplace beginning in the 1980s resulted in a less regulated environment and removed the clear distinction between the pillars, leading to integration and consolidation in the financial sector.

With cross-ownership permitted, most large deposit-taking trust companies were purchased by banks, and trust company regulation in BC has received little focus since this market consolidation. Since 2004, the incorporation of provincial deposit-taking trust companies has not been permitted by the FIA (existing provincial companies were grandfathered).

BC regulates provincially incorporated trust-only trust companies, but the primary solvency regulator of extra-provincial trust companies in BC (including all deposit-taking trust companies) is the regulator in the home jurisdiction.<sup>43</sup> The primary regulator is the regulator responsible for registration, authorization, solvency requirements and regulation, etc. Provinces remain responsible for the market conduct of all trust companies in their jurisdiction (both trust-only and deposit-taking trust companies).

For provincial trust-only trust companies, the FIA imposes a minimum capital requirement. It is the amount determined by multiplying the total value of the assets that the company holds in trust by 0.5 percent. This level has been in place since the adoption of the FIA in 1990 and has not been reviewed.

Government has received very few complaints about trust companies, and because the law of trust has been well developed by the courts and supplemented by general law applicable to all trustees (corporations and individuals), the FIA has limited provisions relating to trust companies and their fiduciary duties.<sup>44</sup>

However, recently concerns were raised about potential conflicts of interest and lack of provincial oversight in relation to trust companies that are subsidiaries of deposit-taking financial institutions. Specifically – in the case of trust assets associated with registered plans held in deposit accounts – whether the use of the trust assets for the benefit, at times exclusive, of the financial institution that owns the subsidiary acting as trustee means, or creates the appearance, that the fiduciary’s trust obligation is not being met. While the enforcement of general trust law obligations is not the role of the FIA, the issue is whether there should be additional regulatory oversight to deal with potential conflicts of interest and fair treatment of consumers.

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<sup>43</sup> Most of the deposit-taking trust companies in BC are incorporated federally, so OSFI is the primary regulator.

<sup>44</sup> The fiduciary duty imposed on trustees, including trust companies, is a very high standard of care and often higher than standards imposed on other financial service sector market participants.

Questions:

- 1) Are there concerns with potential conflicts of interest between financial institutions and subsidiary trust companies? Is further regulation needed in this area? If so, how should the problem be addressed (e.g., through specific trust company regulations, a code of market conduct, or regulation of the primary entity)?
- 2) Do the capital requirements for provincial trust-only trust companies need to be updated?
- 3) Are there other issues with the current provincial framework for oversight of trust companies?

**Issue 2: Regulation of Trust Business**

Historically, financial services sector legislation has only regulated trust business undertaken by corporations. Individuals (and other entities/associations not captured by the definition of a corporation) offering trust services are not subject to licensing under financial institutions statutes in BC or other jurisdictions, and, unlike for deposit and insurance business, there is no general prohibition against individuals and non-corporate entities undertaking trust business.

Some individuals conducting trust business may be regulated under other frameworks (e.g., lawyers and real estate or bankruptcy trustees) and subject to legal duties and powers set out in legislation and in common and equity law. However, although statutory, common and equity law respecting trusts and trustees may apply to their activities, other persons seeking to undertake trust business are not subject to regulatory requirements.

Through the use of electronic commerce, individuals and associations are able to engage with consumers and offer trust services more easily than before, and, as BC's population ages, there will likely be growth in the provision of trust services aimed at seniors. In addition, government has become aware of situations where employers have used unregulated private individuals to set up employee benefit trusts for their employees. Where trust services are provided by unregulated entities, there are potential risks and consumer protection issues.

A separate potential issue relates to certain organizations which administer trust funds, the interest from which benefits third parties. Concerns have been raised with government about the low returns being generated from those funds.

Questions:

- 1) Should financial institutions legislation be expanded to regulate or generally prohibit (subject to exemptions) trust business carried on by individuals or associations?
- 2) If the legislation is expanded to regulate trust business carried on by individuals or associations, what exemptions should be provided (e.g., for lawyers, real estate agents, bankruptcy trustees or individuals providing services to corporate entities)? Should a distinction be made between trust activities for personal and business related purposes?
- 3) Are further exemptions needed in respect of trust business undertaken by corporate entities (e.g., broker dealers)?

- 4) Given that practically all deposit-taking trust companies are now federally regulated, should BC still be requiring trust companies to obtain a business authorization? Does this remain a core element of financial institutions regulation?
- 5) Should government consider adopting minimum standards, a code of conduct or another mechanism to regulate interest generated from trust funds, where the interest from the fund benefits third parties or the public?

## GLOSSARY

“**Basel**” refers to the Basel Committee on Banking Supervision, the primary international standard setter for the prudential regulation of banks. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide to enhance financial stability. It has international membership, including from Canada, the United States and the European Union. It has developed a series of standards (Basel I in 1988, Basel II in 2004, and Basel III in 2010-11).

“**Central 1 Credit Union**” is the primary liquidity manager, payments processor, and trade association for credit unions in BC and Ontario. Central 1’s key legislated role is as the BC credit union system’s liquidity provider, and all BC credit unions are required to be members of and hold statutory liquidity with Central 1.

“**Commission**” is the Financial Institutions Commission (also referred to as FICOM). It has statutory authority for the regulation of financial institutions in BC. It is established under the FIA and its members are appointed by the Lieutenant Governor in Council.

“**CUDIC**” is the Credit Union Deposit Insurance Corporation, a statutory corporation of the BC government administered by FICOM. CUDIC is responsible for administering and operating a deposit insurance fund and guarantees all deposits and non-equity shares of BC credit unions.

“**CUIA**” is the *Credit Union Incorporation Act*, the BC legislation that provides the framework for incorporation and corporate governance of credit unions.

“**FIA**” is the *Financial Institutions Act*, the BC legislation that provides the regulatory framework for credit unions, insurance companies and intermediaries, and trust companies.

“**FICOM**” is the Financial Institutions Commission appointed by the Lieutenant Governor in Council which has statutory authority for the regulation of financial institutions in BC. (While FICOM is also used to refer to the organization headed by the Superintendent which supports the Commission, for purposes of this paper “FICOM” is a reference to the Commission itself.)

“**Financial institution**” means a credit union, insurance company, or trust company.

“**Insurance Council of British Columbia**” is the regulatory body responsible for licensing and discipline of insurance agents (life and general), insurance salespersons, insurance adjusters, and restricted travel insurance agents.

“**OSFI**” is the Office of the Superintendent of Financial Institutions, the Canadian federal regulator of financial institutions subject to federal oversight.

“**Stabilization Central Credit Union**” is a central credit union whose role is to identify and assist credit unions facing governance, operational or financial challenges, and to manage a stabilization fund that can be used to help credit unions experiencing difficulties meet supervisory expectations. BC credit unions are required to be members of Stabilization Central.

“**Superintendent**” is the Superintendent of Financial Institutions. The Financial Institutions Commission may delegate most of its powers and duties to the Superintendent, who undertakes the day-to-day regulation and supervision of financial institutions in BC.