

**SUBMISSION OF
STABILIZATION CENTRAL CREDIT UNION
OF BRITISH COLUMBIA**

**IN RESPONSE TO FIA & CUIA REVIEW -
INITIAL PUBLIC CONSULTATION PAPER**

September, 2015

EXECUTIVE SUMMARY

This submission of Stabilization Central Credit Union of British Columbia (“Stabilization Central”) addresses two topics in response to the initial public consultation paper on the review of the *Financial Institutions Act* (the “FIA”) and the *Credit Union Incorporation Act* (the “CUIA”): (1) the mandate/role, powers and governance of Stabilization Central; and (2) ombudservices for BC credit unions.

Stabilization Central was created as part of a reorganization of BC’s regulatory and deposit insurance system in 1989, in response to the industry’s demand for a system-based stabilization entity. It is recognized under the FIA as the “stabilization authority”, but it is also a central credit union that is owned and controlled by British Columbia credit unions. Stabilization Central plays an important role in ensuring the stability of the BC credit union system and is part of the safety net protecting depositors and the system in the event of a failure.

While the mandate of Stabilization Central is to help protect the British Columbia credit union system, the current regulatory framework presents some challenges which prevent Stabilization Central from being as effective as it otherwise could be. These challenges include:

- Lack of clarity about its mandate/role in the legislation;
- Limitations on access to information which could assist in the early identification of risks; and
- Restricted involvement in the oversight of credit unions, despite Stabilization Central being responsible for the first \$30 million of financial assistance that is paid to distressed or troubled credit unions.

Enhanced Self-Regulatory Role

The main premise of this submission is that Stabilization Central should take on an enhanced self-regulatory role on behalf of British Columbia credit unions.

Credit unions are financially responsible for stability in the credit union system through their joint and several liability under the deposit insurance fund. Given that credit unions are ultimately accountable, it makes sense for a system-owned entity to play a significant role in the early identification of risk and the early intervention process. A system-based entity has a vested interest in mitigating the overall exposure to the system and to the public.

The majority of BC credit unions are supportive of Stabilization Central acting as a self-regulatory organization on behalf of the credit union system. It is important, however, that any enhanced role for Stabilization Central does not result in an additional regulatory burden for credit unions. An enhanced regulatory role would require coordination between Stabilization Central and the Financial Institutions Commission (“FICOM”), and a clear division of responsibilities.

Office of the Ombudsman

Stabilization Central recommends that the BC credit union system adopt an ombudsman process, whereby credit unions follow an industry standard process for consumer complaint handling and escalate unresolved complaints to an Office of the Ombudsman established by the credit union system.

It is proposed that Stabilization Central should act as the Office of the Ombudsman for the BC credit union system. Stabilization Central is a BC-focused central credit union of which all BC credit unions are statutorily required to be members. Stabilization Central provides a system-based response, while maintaining the appropriate level of independence which is required of an ombudsman.

A. Introduction

This submission of Stabilization Central Credit Union of British Columbia (“Stabilization Central”) is made in response to the initial public consultation paper on the review of the *Financial Institutions Act* (the “FIA”) and the *Credit Union Incorporation Act* (the “CUIA”). This submission addresses two topics: (1) the mandate/role, powers and governance of Stabilization Central; and (2) ombudservices for BC credit unions.

B. Mandate/Role, Powers and Governance of Stabilization Central

Pages 27 and 28 of the initial public consultation paper discuss Issue 5: Responsibility and Regulation of Central Credit Unions. Stakeholder commentary in relation to the mandate of Stabilization Central is requested on page 28:

“Are changes or clarifications to Stabilization Central’s mandate/role, powers or corporate governance structure needed?”

1. Foundational Principles of Stabilization Central

Stabilization Central was created as part of a reorganization of British Columbia’s regulatory and deposit insurance system in 1989, in response to the industry’s demand for a system-based stabilization entity. It originated from the principle that the credit union system should deal with its own problems and should not rely on a government body to intervene and resolve the financial and operating challenges encountered by BC credit unions. History has shown the necessity of having adequate early warning systems to identify problems and early intervention systems to resolve them in a swift and flexible manner. Stabilization Central plays an important role in these functions and is part of the safety net protecting depositors and the credit union system in the event of a failure.

Stabilization Central is recognized under the FIA as the “stabilization authority”, but it is also a central credit union that is owned and controlled by British Columbia credit unions. It works with credit unions either on its own initiative or formally on behalf of the Financial Institutions Commission (“FICOM”) when specific credit unions are placed under an order of supervision.¹ The FIA requires that all BC credit unions must be members of Stabilization Central.

The following are some additional principles upon which Stabilization Central is based:

- Credit unions are financially responsible for stability in the credit union system through their joint and several liability under the deposit insurance fund. Given that credit unions are ultimately accountable, it makes sense for a system-owned entity to play a significant role in the early identification of risk and the early intervention process. A system-based entity has a vested interest in mitigating the overall exposure to the system and to the public;

¹ FICOM may, in its discretion, delegate certain powers of supervision to the stabilization authority with respect to a credit union that has been placed under an order of supervision, provided that the conditions in section 285 of the FIA are met.

- There is significant reputational risk to credit unions of all sizes should another credit union fail (no matter how big or small the failing credit union may be). Again, this is another reason for credit unions to be involved in the process. In addition, the public may perceive intervention by a government body as more negative than an internal system intervention;
- There is a benefit in having a credit union self-regulatory organization that can become involved with credit unions at an early stage, before a regulatory standard is breached, to bring about a resolution. Experience has shown that if solutions are only implemented once a regulatory standard has been breached, it is often too late to rehabilitate the credit union;
- Experience has also shown that the cost of dealing with the rehabilitation of credit unions is exponentially higher if the problem is not addressed early in the process. Credit unions are more likely to be open about emerging problems with system-owned entity than with a government regulator; and therefore, with a system-owned entity involved, those problems are more likely to be dealt with before they end up costing the system as a whole;
- A system-controlled organization brings a certain depth of knowledge to the challenges encountered by member credit unions, with solutions that can be implemented in a manner that is sensitive to the circumstances of a particular credit union and the credit union system as a whole;
- There is significant value in having a system-controlled entity that develops and brings greater focus to prevention programs and risk mitigation, which are directed at ensuring appropriate governance and controls within member credit unions.

2. Current Mandate and Role

Simply stated, the mandate of Stabilization Central is to help protect BC's credit union system. This mandate is fulfilled in the following manner:

- *Stabilization Services.* Stabilization Central works with credit unions under delegated authority from FICOM and through voluntary engagements to support compliance with regulatory requirements. The organization also monitors emerging risks to the credit union system to assist in the development of mitigation strategies when necessary;
- *Master Bond Program.* In addition to early monitoring and intervention responsibilities, Stabilization Central is responsible for the administration of the Master Bond Program, which provides insurance to BC credit unions against fidelity and other risks;
- *Credit Union Support Programming.* While monitoring and intervention assistance remains Stabilization Central's focus, the organization develops support programming to assist credit unions in satisfying regulatory requirements;

- *System Risk Mitigation.* By monitoring emerging risks facing credit unions, Stabilization Central provides an independent perspective with respect to potential impacts of external developments and key initiatives within the credit union system. The organization assesses the implications of such risks to credit union operations and develops support programming to assist credit unions in mitigating these risks.

Stabilization Central is an entity with unique capacity, because it is a central credit union of which every credit union in the Province is a member. In addition to the above-mentioned activities, Stabilization Central has the ability to:

- Raise and maintain a stabilization fund for depositor protection and other purposes;
- Manage part of the deposit insurance fund as a deposit insurance corporation pursuant to the *Income Tax Act* (Canada);
- Gather and analyze statistical and financial data for early warning and early intervention;
- Undertake various projects to build a more stable credit union system;
- Provide financial assistance to credit unions in order to assist with various risk mitigation scenarios, as appropriate;
- Act as conduit to absorb “bad assets” from credit unions in time of crisis;
- Act as a conduit through which credit unions can transfer financial resources and management expertise in crisis situations.

3. Current Regulatory Framework

Stabilization Central is not expressly referred to in the FIA or the CUIA. Instead, references are made in the legislation to the “stabilization authority”. Stabilization Central was created for the purposes of acting as the stabilization authority, and has been designated as the stabilization authority by order-in-council pursuant to section 282 of the FIA.

The legislation does not contain much commentary about the stabilization authority. It does, however, set out two important provisions as follows:

- It is a condition of every business authorization issued to or held by a credit union that it is a member of the stabilization authority (s. 283, FIA); and
- FICOM may delegate its powers of supervision under section 277(a) to (d) of the FIA to the stabilization authority (s. 285, FIA).

4. Challenges

The current regulatory framework presents some challenges which prevent Stabilization Central from being as effective as it otherwise could be.

4.1 Lack of Clarity About Mandate/Role

As noted above, the current legislation does not contain much commentary about the stabilization authority. In many respects, the current framework sets out a voluntary stabilization regime, whereby the role and mandate of Stabilization Central are set out in the Constitution and Rules of Stabilization Central. These constating documents of the organization essentially form a contractual agreement among BC credit unions. Although this approach is flexible, it does not support a long-term vision of the role and mandate of the stabilization authority.

In many respects, the ability of Stabilization Central to fulfill its mandate is dependent on the then-present view of the regulator about the organization. It would be better if the role and mandate of Stabilization Central is clarified and entrenched in the legislation. Ideally, the result would be that Stabilization Central will be able to concentrate its efforts on stabilizing the credit union system. The present lack of clarity is not consistent with international standards of banking supervision. One of the core principles of an effective system of banking supervision as established by the Basel Committee on Banking Supervision is that the system has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups.²

Moreover, this lack of clarity makes it difficult for Stabilization Central to resource itself for a long-term vision. Decisions about staffing, lease premises and other contractual commitments are dependent upon an assessment of the then-current support of the organization from the credit union system and the regulator. Such an approach is no way to operate an effective and integrated system of credit union supervision.

4.2 Access to Information

The ability for FICOM and Stabilization Central to collect and share information relating to credit unions is important for the effective oversight of credit unions and the early identification of risks. The Basel Committee on Banking Supervision has noted that information sharing among those responsible for the safety and soundness of the financial system is an important principle for effective banking supervision.³

FICOM and Stabilization Central are currently parties to an Information Sharing Agreement; however, the Information Sharing Agreement has certain limits that potentially make it difficult for Stabilization Central to gain access to all information that is necessary to effectively identify and manage risk in the system. It would be useful to add Stabilization Central as one of the listed parties to whom the Superintendent and any investigators, examiners or other persons under the direction of the Superintendent must share information (in a similar manner to ss. 219.1(1) and (2) of the FIA).

² Basel Committee on Banking Supervision, “Core Principles for Effective Banking Supervision” (September, 2012), p. 11.

³ Basel Committee on Banking Supervision, “Guidelines for identifying and dealing with weak banks” (July, 2015), p. 11.

4.3 Financial Assistance

Stabilization Central is party to an agreement with the Credit Union Deposit Insurance Corporation of British Columbia (“CUDIC”), whereby Stabilization Central has agreed to pay the first \$30 million on the deposit insurance guarantee and for any financial assistance that is required for distressed or troubled BC credit unions. It is the objective of Stabilization Central that CUDIC will never need to make a payment out of the statutory deposit insurance fund.

With this commitment in mind, it is imperative that Stabilization Central be able to effectively monitor, evaluate and manage the related risk. However, currently, Stabilization Central is not automatically entitled to play a role in the intervention of a credit union and, in some circumstances, does not get the opportunity to do so. The regulatory framework should be amended to allow Stabilization Central to have greater access to information about credit unions (including copies of examinations, investigations and audit reports) and be involved in the intervention of any credit union with respect to which Stabilization Central may be called upon to provide financial assistance.

5. Enhanced Self-Regulatory Organization (“SRO”) Role

It is proposed that Stabilization Central be granted the authority of a self-regulatory organization for British Columbia credit unions. The following supports this approach:

- The majority of BC credit unions are supportive of Stabilization Central becoming a self-regulatory organization on behalf of the credit union system.⁴ Many have pointed out the benefits of having Stabilization Central involved in the early identification of risks through its monitoring activities and in the process of addressing problems before they develop to the point where regulatory intervention by FICOM is required. It is important, however, that any enhanced role for Stabilization Central as a SRO does not result in an additional regulatory burden for credit unions. Credit unions may see the value in an enhanced SRO, but do not want to satisfy the demands of two regulators. An enhanced regulatory role would require coordination between Stabilization Central and FICOM, and a clear division of responsibilities, without duplication.
- FICOM has the support of SROs in other industries that it oversees. The current ability of Stabilization Central to effectively support FICOM as a credit union SRO is limited because of the challenges noted above. It is our understanding that FICOM would like to see a strong SRO in the credit union sector.
- As noted above, Stabilization Central is contractually committed to pay the first \$30 million on any claim on the deposit insurance guarantee and any financial assistance to distressed or troubled credit union. Therefore, Stabilization Central has a vested interest in the protection of the public and the stability of the credit union system.

⁴ Stabilization Central Credit Union, “Member Engagement & Feedback Process - Final Report” (September 12, 2012), pp. 6 and 7.

- Given that it is a system-owned and controlled entity, Stabilization Central has access to the breadth of expertise and credit union knowledge that is necessary to effectively support BC credit unions.
- History has shown that, despite its challenges and limitations, the involvement of Stabilization Central has resulted a more stable system and reduced overall costs in the supervision and oversight of credit unions.
- Stabilization Central is an organization that is focused on sound risk management, early detection, timely intervention and cost-effective resolution of issues. These objectives align well with the objectives of the legislative and regulatory framework under the FIA and CUIA.

6. Governance

The initial public consultation paper asks for feedback with respect to the governance structure of Stabilization Central. At present, the governance structure of Stabilization Central is set out in its Rules, which provide that there will be seven directors of Stabilization Central. Six directors are elected by peer groups made up of BC credit unions and one director is appointed by the Board of Directors of Stabilization Central.⁵ If the member credit unions wish to change the governance structure of Stabilization Central, they could do so by making amendments to the Rules of the organization.

In the event that Stabilization Central is given significantly more powers as an enhanced self-regulatory organization, it may be necessary to consider some alternate governance structures. Ultimately, however, it will be important to maintain the “system-owned and controlled” nature of Stabilization Central as the system-based stabilization authority.

C. Ombudservices

1. Office of the Ombudsman

The initial public consultation paper on the review of the FIA and CUIA asks whether BC credit unions should be required to have an internal complaint handling process and to offer member access to an independent ombudservice. Stabilization Central recommends that the BC credit union system should adopt an ombudsman process, whereby credit unions follow an industry standard process for consumer complaint handling and escalate unresolved complaints to an Office of the Ombudsman established by the credit union system.

It is proposed that Stabilization Central should act as the Office of the Ombudsman for the BC credit union system. Stabilization Central is a BC-focused central credit union of which all BC credit unions are statutorily required to be members. Stabilization Central provides a system-based response, while maintaining the appropriate level of independence which is required of an ombudsman.

⁵ The peer groups have traditionally followed the same peer groupings as used by Central 1 Credit Union. The peer groups are generally aligned by geographical location of the credit unions.

With Stabilization Central designated as the Office of the Ombudsman, the cost of ombudservices would be absorbed by the credit union system and not by government. Furthermore, the role of the Office of the Ombudsman fits well with the mandate of Stabilization Central, which is to protect depositors and the BC credit union system.

2. Proposed Process

A proposed process for a provincial ombudsman for BC credit unions is attached as a Schedule to this submission. The proposed process outlines three steps:

- Step 1 – Credit Union (*i.e.*, internal complaint handling process)
- Step 2 – Provincial Ombudsman (*i.e.*, Stabilization Central)
- Step 3 – Mediation (*i.e.*, third party mediation)

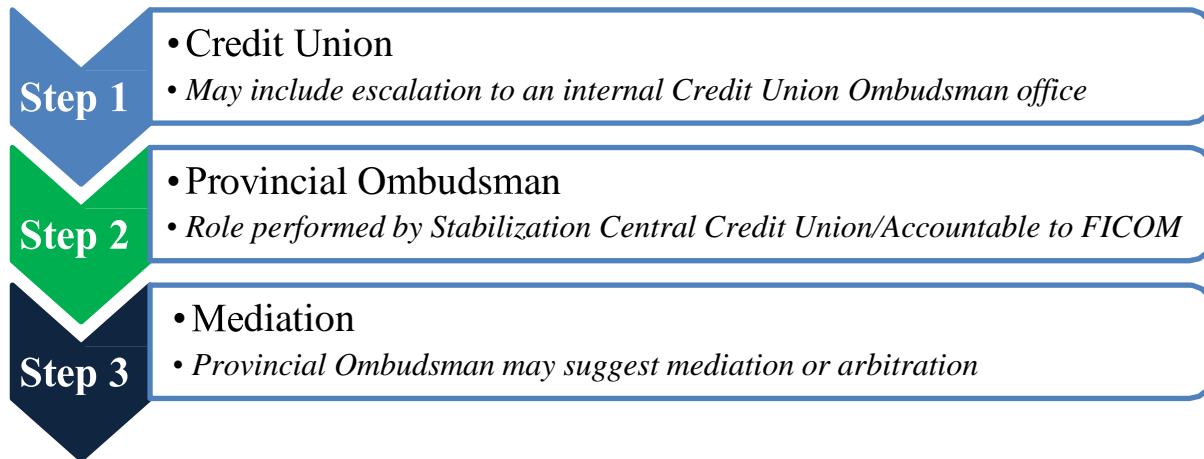
In functioning as the Office of the Ombudsman, Stabilization Central would be accountable to FICOM and would prepare and provide reports to FICOM on a regular basis. FICOM would have regulatory oversight with respect to the Office of the Ombudsman and be responsible for monitoring the performance of the Ombudsman.

SCHEDULE



Provincial Ombudsman for BC Credit Unions

Process:



Overview:

Step 1. Credit Union

The initial stage in the member redress process will be at the credit union level. Credit union employees will attempt to resolve the member's concerns. All complaints should be in writing and include the desired resolution outcome.

If the member remains unsatisfied, the complaint may be escalated to the provincial ombudsman.

Step 2. Provincial Ombudsman

Unresolved problems involving the credit union may be escalated to the BC credit union provincial ombudsman. The ombudsman seeks satisfactory resolution of complaints with a view to fairness and does not advocate for either the credit union or the complainant when investigating disputes.

This service is free of charge to the complainant, but there is no provision for the award of costs to solicitors or other professionals and recommendations are not binding on credit unions.

The Ombudsman shall prepare and disclose reports (with member identifiers removed) on a regular basis to the Regulator (FICOM), as well as other information that the Regulator considers appropriate for its oversight interest, and any information required by law. The Ombudsman is governed by the Regulator, which is responsible for overseeing the Ombudsman and monitoring its performance and accountability.

The Regulator does not consider specific complaints. The final decision concerning complaints rests with the Ombudsman, or an external, independent mediator, if applicable. There is no appeal to the Regulator. The Regulator may, however, consider any member concerns about the conduct of the Credit Union and about the general complaint-handling process.

Step 3. Mediation

Certain disputes that remain unresolved after being reviewed by the provincial ombudsman may be referred for mediation. The provincial ombudsman may suggest – or a member may request – an external mediator. A mediator helps the parties involved work toward a mutually acceptable resolution.