

*Financial Institutions Act &
Credit Union Incorporation Act*
Review
Preliminary Recommendations



Ministry of
Finance

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FIA & CUIA REVIEW – PRELIMINARY RECOMMENDATIONS

FINANCIAL INSTITUTIONS ACT & CREDIT UNION INCORPORATION ACT REVIEW **SECOND PUBLIC CONSULTATION PAPER**

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INTRODUCTION

The Ministry of Finance is currently undertaking a broad review of the *Financial Institutions Act* (FIA) and *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 purpose of the FIA/CUIA review is to consider the regulatory tools BC has to oversee credit unions, insurers and intermediaries, and trust companies, and whether changes to the legislative and regulatory framework are needed. To ensure that the regulatory framework continues to be effective, efficient and modern, both the FIA and the CUIA require that a review of the legislation be initiated every ten years.

It should also be noted that, regardless of the statutory requirement that a review of the FIA and CUIA be initiated every ten years, the Ministry is committed to ensuring that the legislative and regulatory framework remains current and will review the framework more frequently as necessary.

Process to Date

The Ministry released an initial public consultation paper in 2015. The purpose of that paper was to seek input from stakeholders and other interested parties for consideration as part of the review.

Submissions were received from the credit union system and individual credit unions, insurance sector and intermediary organizations, trust companies, public sector organizations, businesses, banking and other organizations, and individuals. After the submission period ended, Ministry staff met with a number of these stakeholders to discuss their submissions.

A public report on the stakeholder input received in response to the initial public consultation paper was released in 2016. The report and stakeholder submissions are posted on the Ministry of Finance website (<http://www.fin.gov.bc.ca/pld/fiareview.htm>).

In addition to the broad review of the FIA and CUIA, a review of the governance and structure of FICOM was undertaken in late 2017 to assist in providing recommendations to ensure that its governance and organizational structure is clear, appropriate and contributes to the overall goals and objectives of government.

Purpose of the Preliminary Recommendations Paper and Next Steps

This paper represents the next stage of the consultation process; it sets out policy recommendations, including proposals related to the governance and structure of FICOM, and provides an opportunity for stakeholders to review the proposed changes.

The recommendations do not represent government policy; rather, the paper is intended to elicit discussion.

Feedback from stakeholders on this paper's proposed changes will help guide government as it considers legislative changes to the FIA and CUIA. After consultation and analysis, Ministry staff will prepare specific policy proposals for the consideration of government. Ultimately, any proposed changes to the FIA and CUIA would be subject to consideration and approval by the Minister of Finance and Cabinet, and approval of the Legislature of British Columbia.

How to Provide Input

Submissions and comments must be received by June 19, 2018 and may be transmitted electronically to 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 you prefer that certain comments not be posted publicly or shared with other parties, please clearly indicate this in your 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

The FIA provides the regulatory framework for credit unions, insurance companies and intermediaries, and trust companies, and the related CUIA provides the framework for incorporation and corporate governance of credit unions.¹

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 greater proportions 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 BC's economy and to communities throughout the province.

Although much has changed since the previous legislative 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 Institutions Commission

The Financial Institutions Commission (Commission), along with the Superintendent of Financial Institutions (Superintendent), is responsible for regulating and supervising financial institutions in BC—credit unions, insurance companies and intermediaries, 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.

¹ 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 last reviewed and updated in 2009.

The Commission is established under the FIA and its members are appointed by the Lieutenant Governor in Council (LGIC). 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 LGIC, after consultation with the Commission Chair, and the Commission provides oversight and direction to the Superintendent.

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 the purposes of this paper a reference to FICOM is a reference to the Commission, as it is the Commission that has the statutory authority for the regulation of financial institutions in BC.^{2, 3}

² The Superintendent also holds certain powers under the FIA that are separate and apart from those held by the Commission.

³ 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 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 RECOMMENDATIONS

The remainder of this paper sets out a summary of the preliminary recommendations being made in respect of the FIA/CUIA review.

As in the initial consultation paper, 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 includes proposals related to the governance and structure of FICOM; as well as separate sections for each of the credit union, insurance and trust sectors which contain the issues that primarily, or exclusively, apply to that sector.

For each issue, recommendations have been set out and are followed by a high level rationale for that recommendation. Please note that the issues and recommendations have been numbered for ease of reading and discussion and do not reflect any sort of ranking of the issues.

OVERALL FRAMEWORK ISSUES

Governance and Structure of FICOM

Recommendation #1

Establish FICOM as a Crown agency.

While not raised as an issue in the initial public consultation paper, issues related to the governance and structure of FICOM were raised by a number of stakeholders during the consultation period, particularly in the credit union sector.

Under this proposal, FICOM would be established as a Crown agency. FICOM would be authorized to operate as an independent, self-funded government agency, accountable to the provincial legislature through the Minister of Finance. This proposal aligns with international standards for financial sector regulators.

Recommendation #2

Expand the mandate of the Commission to exercise certain powers and duties related to mortgage brokers and pension plans.

The Superintendent serves in several official capacities, including Superintendent of Financial Institutions, Superintendent of Pensions, Registrar of Mortgage Brokers and CEO of the Credit Union Deposit Insurance Corporation (CUDIC) under the corresponding legislation.

Currently the Commission exercises powers and carries out duties assigned to it under the FIA and the CUIA relating to the regulation and supervision of provincially authorized insurance companies, trust companies and credit unions. Through the exercise of FIA and CUIA powers, the Commission makes major regulatory decisions regarding incorporations, business authorizations, amalgamations, liquidations and windups. Under the current framework, the Commission does not have any oversight of mortgage brokers or pensions.

Under this proposal the mandate of the Commission would be expanded to include mortgage brokers and pension plans. In order for the Commission to take on this expanded mandate, a Commission structure that reflects best practices and includes expertise from the regulated sectors will be required. Public sector board governance guidelines would also apply.

Recommendation #3

The Commission will appoint the CEO and statutory decision makers of FICOM.

Under this proposal the CEO and statutory decision makers (i.e., Superintendent of Financial Institutions, Superintendent of Pensions, and Registrar of Mortgage Brokers) will be appointed by the Commission and will be accountable to the Commission. Structural changes to the Commission, including the requirement that the Commission have sector-specific expertise, will ensure that the Commission has the capacity to effectively oversee the operations and strategic direction of the regulatory agency and to oversee the statutory decision makers.⁴

Recommendation #4

CUDIC will continue to be administered by FICOM and members of the Commission will continue to serve as the CUDIC board.

Under this proposal, no changes would be made to the structure of CUDIC, which would continue to be administered by FICOM. CUDIC was merged with FICOM in 1990 to allow expertise to be pooled; that pooling of expertise continues to be relevant and important today.

Regulatory Powers and Guidelines

Recommendation #5

Provide FICOM with the authority to issue enforceable guidelines/rules. Guidelines/rules will require public consultation and Ministerial approval.

International standards have increasingly focused on regulators having the appropriate tools to review and evaluate financial institutions and the ability to intervene on a timely basis to address problems at an early stage. Rules issued by financial sector regulators are increasingly being relied upon around the world as an important tool due to their flexibility and their ability to be adopted and amended in a timely manner (in comparison with legislation and regulations).

Currently FICOM can, and does, issue guidelines. The guidelines do not replace legislative or regulatory requirements, but rather reflect what is in the legislation, clarify supervisory

⁴ The Commission itself is also a statutory decision maker.

expectations, and inform supervisory assessments. The FIA grants authority to the Insurance Council of British Columbia (Insurance Council) to make legally enforceable requirements or standards in the form of Council rules (e.g., rules respecting licensing, supervision, education and conduct). Similarly, the *Securities Act* provides the British Columbia Securities Commission (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 entity has been delegated rule-making authority. The rules they make are not issued for the purposes of interpreting the legislation, but instead impose legally binding requirements. In part because they are substantive rules having the same enforceability as regulations, each proposed rule must be published for public comment and the Minister of Finance can either consent to or reject it.

Under this proposal, FICOM would be provided with rule-making authority. All rules would be subject to public consultation and Ministerial approval. The legislation would set out the specific matters on which FICOM may make rules.

Recommendation #6

Consistent with the rule-making authority described in Recommendation #5, require industry/public consultations and Ministerial approval of the deposit insurance assessment methodology.

Under the FIA, FICOM is authorized to assess each credit union a contribution to the deposit insurance fund. FICOM sets a target size for the deposit insurance fund and determines the annual contribution each credit union is required to make to the fund. For credit unions, the methodology for the calculation of deposit insurance premiums/contributions is an important issue and was raised a number of times during the initial consultation phase of the FIA/CUIA review.

Under this proposal, FICOM would be provided with the authority to make rules respecting the determination of annual premiums for credit unions, subject to consultation and Ministerial approval. This approach is consistent with the federal framework for bank deposit insurance assessments. The deposit fund target size, including the timelines for achieving the target, would continue to be determined independently by FICOM.

Recommendation #7

Continue to apply federal capital standards to BC insurance companies but provide FICOM with: (1) the discretion to disapply some requirements; and (2) the authority to issue rules to modify, where appropriate, capital requirements for BC insurance companies.

Most insurance companies in BC are federally-incorporated. The federal regulator has traditionally led the development of solvency standards for insurers and 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. Under the FIA, the capital requirements for insurance companies are based on the guidelines issued by the federal regulator (Office of the Superintendent of Financial Institutions [OSFI]).

Under this proposal, FICOM would have the discretion to disapply specific requirements where appropriate and would also have rule-making authority to apply alternative requirements for BC insurance companies. This would allow FICOM to tailor requirements to risks that may be unique to BC. All rules would be subject to industry/public consultation and Ministerial approval.

Market Discipline

Recommendation #8

Authorize FICOM to collect and publish certain financial and risk information.

Enhancing public disclosure requirements would help bring BC's legislative framework up-to-date with global standards. This proposal would also align BC requirements with federal requirements (and Alberta requirements for insurers) and would provide consistency in reporting to help customers and investors compare financial institutions across jurisdictions.

Under this proposed change, the specific information that could be collected and published by FICOM would be set out in regulation. The intent would be to allow FICOM to publish: (1) financial statements and auditors' reports, which financial institutions are already required to make publically available; (2) additional financial and risk information, such as that required by OSFI, Alberta, and Quebec; and/or (3) aggregate financial and risk information that does not identify distinct financial institutions. As with any regulation, the specific items that FICOM would have the authority to disclose would be subject to Ministerial and Cabinet approvals. Financial institutions would only be obligated to supply information to the regulator and would not be responsible for making such information publically available.

Further analysis would be necessary to determine specific information that may be of value to consumers and investors. Consideration would be given to the size and complexity of financial institutions to ensure small institutions are not overburdened. Attention would also be paid to ensure that increased disclosure requirements do not undermine cooperation with the regulator and confidence in financial institutions. As well, increased disclosure requirements must not result in customer information being revealed. There would be no change to the current requirement for FICOM to maintain strict confidentiality of all other information it receives from financial institutions.

Recommendation #9

Require financial institutions to make their public disclosures (i.e., financial statements and auditor's reports) available online.

Under this proposal, BC-incorporated financial institutions would continue to be required to keep a copy of their required public disclosures at each branch or office location, and would also be required to make these documents available on their public websites.

This proposal reflects changes in technology and modernizes the legislation. Consumers and investors would benefit from faster and more convenient access to information. Most, if not all, financial institutions already maintain public websites and as such, an online disclosure requirement should not be overly burdensome for financial institutions.

Recommendation #10

Provide FICOM with clear authority to share information with the existing national insurance reporting database and/or the proposed new national market conduct database.

In 2005, insurance regulators in Quebec and Ontario contracted a private company to develop a joint insurance complaint reporting system to reduce duplication and harmonize regulatory reporting. The system has since been expanded nationwide.⁵ BC is the only province that has not joined the system because it is currently ambiguous whether the FIA allows BC to join.

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

⁵ More recently, the Canadian Council of Insurance Regulators (CCIR) has been working to replace the national complaint reporting system with a new national market conduct database, which will be administered by Quebec's Autorité des marchés financiers (AMF).

regulatory regime. BC's participation in an integrated national database would help regulators in identifying and assessing issues in the insurance marketplace.

Under this proposal, information sharing would be handled by FICOM to avoid placing a burden on small institutions.

Out of Province Business

Recommendation #11

Clarify that the FIA regulatory requirements (e.g., business authorization, solvency, market conduct) do not apply to federal credit unions incorporated under the *Bank Act*.

Clarification of the FIA's definition of "credit union" to exclude credit unions that are regulated as banks under the *Bank Act* is warranted to keep the FIA up-to-date with federal legislative changes.

Recommendation #12

Make amendments to the framework for cross-border operation of credit unions to:

- (a) Maintain/update the reciprocal framework for cross-border operation of credit unions (branch operations) so it is available if any other province establishes an operational reciprocal framework.**
- (b) Provide FICOM and CUDIC more guidance for the exercise of their discretion in whether to approve BC credit unions intending to open extraprovincial branches.**
- (c) Specify that under the reciprocal framework, an extraprovincial credit union must have deposit insurance from either home or host regulator and allow regulations to apply other aspects of the FIA to extraprovincial credit unions operating in the province.**

In 2004, the FIA was amended to permit retail credit unions to operate extraprovincially on a reciprocal basis. BC is currently the only province that has implemented a functioning legislative framework for extraprovincial credit unions. As no other jurisdiction has a reciprocal framework that is operational, no extraprovincial credit union can operate in BC and no BC credit unions can operate in other provinces. With the new *Bank Act* provisions allowing credit unions to incorporate/continue federally, credit unions now have the option of operating extraprovincially under the federal legislation.

However, it is not clear whether the federal framework will ultimately meet credit union needs. Therefore, it appears warranted to leave the reciprocal framework in place.

The proposed amendments could allow for a more carefully tailored regulatory approach based on assessment of the specific regulatory risks of cross-border operation of credit unions. Similar to the Ontario framework, regulations could be adopted if and when another jurisdiction decides to implement a framework for cross-border operation of credit unions.

Under this proposal, FICOM and CUDIC approvals will continue to be required both for BC credit unions operating in other provinces and for other credit unions operating in BC, but the legislation will provide direction and criteria that FICOM and CUDIC will need to consider in making their decision.

Recommendation #13

Prescribe additional business activities that a credit union may carry on outside the province without the approval of FICOM or CUDIC.

The review examined the framework for out-of-province incidental business activities and considered whether additional activities not already permitted under the FIA should be allowed without approval from FICOM or CUDIC.

Some credit unions recommended that the FIA be amended to remove approval requirements for extraprovincial business activities. However, extraprovincial business activities can give rise to exceptional risks, especially in light of limited provincial jurisdiction to regulate activity outside the province. Requiring FICOM approval may be excessive for certain low risk activities but other activities (such as opening branches in other jurisdictions) clearly raise regulatory and other risks. It also appears warranted to require CUDIC approval for out-of-province deposit taking activities that are captured under the CUDIC guarantee. As such, the recommendation is to continue to require FICOM/CUDIC approval of these activities but to allow for further regulatory exemptions to be established for specific kinds of low-risk out-of-province business activity.

This approach would provide some flexibility to allow credit unions to undertake other business activities outside BC, provided they do not raise significant regulatory risks and/or activity that FICOM would not have sufficient tools to properly oversee.

Recommendation #14

Maintain the current general prohibition on the purchase of insurance outside of BC.

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.

The current approach appears to be working well and broad exemptions could undermine the insurance market and consumer protection.

Winding Up of Insurers and Credit Unions

Recommendation #15

Make amendments to more effectively address credit unions facing solvency issues. Specifically:

- (a) Amend the legislation to provide authority for FICOM or the Minister of Finance to establish bridge credit unions.**
- (b) Enhance CUDIC's role in dealing with credit unions facing solvency issues.**

International standards highlight the importance of an effective resolution scheme to any banking regime. Amending the FIA or CUIA to provide the Minister of Finance or FICOM with the ability to establish a bridge credit union would be consistent with the federal framework under the *Canada Deposit Insurance Corporation Act* and would likely lead to better outcomes for members of a troubled credit union.

Enhancing CUDIC's role in dealing with credit unions facing solvency issues would be consistent with the federal framework and would enhance clarity. Further analysis and consideration would be given to designating CUDIC as a resolution authority, with similar tools as are available to the federal deposit insurance corporation.

Recommendation #16

Allow FICOM to apply to the court for an order that an insurance company be wound up if sufficient cause has been shown.

FICOM requires sufficient powers to take action in the event there is an imminent risk to the viability of an insurer. Amending the FIA to clearly outline the procedures for taking control of a troubled insurer or winding up an insurance company will help facilitate the orderly resolution of problems.

Maintaining the status quo would be inconsistent with international standards that highlight the importance of an effective resolution scheme to any framework for financial institutions.

Under this proposal, consideration will be given to requiring FICOM to apply to the court for permission to intervene (similar to those rules in place in Alberta and Saskatchewan, where the legislation specifies under what conditions the regulator can intervene). Consideration would also be given to setting out what actions can be taken by the intervening regulator, as in Quebec.

Financial Literacy

Recommendation #17

Do not amend the legislation to require financial institutions to make investments in financial literacy.

Financial organizations already have an incentive to foster financial literacy, as greater knowledge of available financial products and services generally leads to more consumption of those products and services. Furthermore, financial organizations already actively contribute to financial literacy through a wide variety of initiatives and provided many examples of such initiatives in their submissions to the FIA review. The variety and scope of existing financial literacy initiatives demonstrates that a specific requirement for financial organizations to invest in financial literacy initiatives is not required.

Recommendation #18

Establish a cross-ministry working group to coordinate government's financial literacy efforts.

Several submissions to the FIA review encouraged government to take on a greater role in contributing to and fostering financial literacy. Given the complexity of financial products and

services, government intervention may help to ensure better consumer understanding and protection. A number of initiatives have already been undertaken. For example, the Ministry of Education has embedded financial literacy education instruction throughout the recently adopted K-9 provincial curriculum and updates for grades 10-12 are being developed. The BCSC has a number of programs focusing on financial education and literacy.

Within government, financial literacy objectives reach broadly across several different ministries/organizations in support of a wide range of policy objectives. A coordinated cross-government approach is therefore desirable.

Recommendation #19

If necessary, clarify that financial institutions have the authority to report suspicions of financial abuse to a designated agency under the *Adult Guardianship Act* (AGA).

Financial institutions may make use of the existing provision under the *Adult Guardianship Act* (AGA), which allows reporting of suspected abuse to a designated agency.⁶ Ministry staff will work with financial institutions to ensure that industry is familiar with their authority to report suspicions of financial abuse under the AGA.

While many stakeholders supported a change to allow financial institutions to be able to report suspected financial abuse to next of kin (as now allowed under federal legislation), serious concerns were raised by the Public Guardian and Trustee and the Council to Reduce Elder Abuse, who noted that often, the next-of-kin is the individual perpetrating the abuse. By maintaining the status quo, financial institutions will continue to be able to report suspected financial abuse to the designated agencies referred to in the AGA.

Recommendation #20

Support, where appropriate, Emergency Management BC in developing consumer-friendly communication materials that outline the government's Disaster Financial Assistance program.

A number of submissions, particularly from the insurance sector, suggested that government should better communicate government policies regarding catastrophic risk and disaster preparedness. However, detailed information on disaster preparedness and the province's

⁶ Currently, designated agencies include the five regional health authorities, Community Living BC, and Providence Health Care Society.

Disaster Financial Assistance (DFA) program is already available from Emergency Management BC.

Emergency Management BC is considering producing consumer-friendly material (rather than detailed information bulletins) that describe the DFA program, which could lead to better awareness and understanding of the DFA program and the importance of obtaining earthquake and overland flood insurance.

Fines

Recommendation #21

Increase the maximum fines for offences under the FIA and CUIA.

While not raised as an issue in the initial public consultation paper, the fines available under the FIA have not been reviewed since the legislation was first brought into force in 1989.

Consideration is only being given to the monetary penalties imposed under section 253 of the FIA. The legislative and regulatory framework for administrative penalties was developed relatively recently and does not form part of this recommendation.

Monetary penalties are intended to enhance compliance with legislative requirements and, where those requirements are not met, fines give authorities a way to penalize offenders and encourage future compliance. Monetary penalties need to be sufficiently high to encourage compliance; if monetary penalties are too low, individuals and corporations may willingly pay them rather than adjust their behaviour, viewing the fines as a cost of doing business.

CREDIT UNION SECTOR

Deposit Insurance

Recommendation #22

Continue to provide unlimited deposit insurance to credit union members.

Deposit insurance contributes significantly to consumer confidence and market stability and is an important component of the financial system.

International regulatory organizations caution against unlimited deposit insurance because of the potential incentive for increased risk-taking by financial institutions (i.e., financial institutions may lack incentive to guard against risk when they are protected from its consequences by unlimited deposit insurance). The Basel Committee on Banking Supervision and International Association of Deposit Insurers released a set of core principles which address all aspects of deposit insurance.⁷ 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. Worldwide, 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.

However, there are arguments for BC to continue with unlimited coverage for credit unions at this time. This will allow BC credit unions to remain competitive with other western provinces (which offer unlimited coverage). Most importantly, government must carefully consider that simultaneously imposing multiple changes to the credit union system could negatively impact credit union liquidity.

In light of recommendations 24 and 28, (to modernize capital and liquidity standards using a framework based on Basel III), government is not considering moving to limited deposit insurance at this time. Any future reconsideration of deposit insurance coverage would require further review by the Ministry of Finance at that time and would also include consultation with affected stakeholders, FICOM and other interested members of the public.

⁷ 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>.

Recommendation #23

Make changes to the scope of deposit insurance coverage by excluding or limiting coverage for certain products.

Under this proposal, coverage could be excluded or limited for the following products:

Foreign currency (exclude from coverage): The founding purpose of deposit insurance centers on institutional failure. Foreign currency deposits bear market risk (like stocks, bonds, and mutual funds) that deposit insurance is not intended to protect against. Although Alberta, Manitoba, and Saskatchewan do insure foreign currency deposits, the federal government, Ontario, Quebec and the Atlantic provinces do not (although the federal government is consulting on this issue).

Term deposits (limit coverage of term deposits to those with a length to maturity of five years or less): Term deposits beyond five years can be seen as an investment product rather than a deposit product. While some provinces provide coverage for deposits of any length to maturity, 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 (eliminate or limit coverage): Large interbank deposits raise serious risks for liquidity in times of financial stress.

Non-equity shares (exclude coverage but provide a transition period to convert existing shares to deposits): It appears that credit unions no longer offer these shares, but a transition period is necessary to allow existing non-equity shares to be wound up.

Capital Requirements

Recommendation #24

Adopt a Basel III-like capital framework and guidance/rules-based approach for capital standards, applicable to all provincial credit unions, with modifications to recognize the cooperative nature of credit unions and size differences among credit unions.

All new rules would be subject to consultation and Ministerial approval.

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 2008 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.

Adopting the Basel III capital framework, with modifications to accommodate the unique characteristics of the BC credit union system, would be consistent with federal regulation, and with the approaches in Quebec, Saskatchewan and the recommendations made in Ontario's recent review of the *Credit Unions and Caisses Populaires Act*.

Moving to a guidance/rules-based approach for credit union capital and liquidity standards would mean that FICOM could issue enforceable guidelines, subject to public consultation and Ministerial approval, with respect to capital and liquidity requirements. This approach would make FICOM more consistent with its provincial regulatory counterparts and also allow FICOM to be more flexible and reactive to emerging industry concerns (e.g., development of alternative sources of capital, changes to leverage ratios, treatment of member equity). Furthermore, modernizing capital requirements would result in the elimination of some of the specific impediments that credit unions have expressed concern about (e.g., the commercial cap, the treatment of residential property held through trusts).

A capital regime based on the Basel III framework will take significant time to fully implement and will also require a lengthy transition time.

Recommendation #25

Adopt the credit union system's hybrid proposal for high ratio mortgages at the same time that new capital requirements are adopted.

The credit union system submission recommended that BC change its rules on high-ratio mortgages. Currently, BC applies a risk weighting of 0.35 for mortgages with a loan-to-value ratio (LTV) of up to 75 percent. For loans above the 75 percent threshold, the risk-weighting (for the entire amount of the loan) is 0.75. Therefore there is a significant capital penalty for loans with an LTV above 75 percent. However, unlike banks, credit unions are not prohibited from issuing uninsured high-ratio mortgages (i.e., those with an LTV ratio above 80 percent).

The credit union system has proposed a hybrid model where uninsured mortgages between 75-80 percent LTV are risk weighted at 0.35 (as opposed to the current 0.75), uninsured mortgages between 80-85 percent LTV are risk weighted at 0.75 (which is the same as they are currently risk weighted), and mortgages higher than 85 percent LTV must be insured.

This proposal accommodates the markets that are served by certain credit unions by allowing the few credit unions that provide uninsured mortgages with a higher than 80 percent LTV ratio to continue to do so (provided they do not have a ratio greater than 85 percent).

However, there are concerns with implementing this proposal before a new, more risk-sensitive capital framework is in place, particularly in light of current economic conditions (rapidly

increasing real estate prices, high consumer debt loads) and the possibility of a correction in the future.

Recommendation #26

Continue to allow 50 percent of system capital to count towards individual credit unions' capital requirements, but remove CUDIC funds from the definition of system capital.

While including components of system capital may not be entirely consistent with international standards/Basel III, prohibiting the use of system capital as a component of individual credit unions' capital bases would fail to recognize the cooperative support structure under which Central 1 and Stabilization Central manage the risks to the credit union system and provide assistance to credit unions in financial difficulty.

The inclusion of CUDIC's retained earnings in system capital, however, is problematic because the purpose of deposit insurance is to protect individual depositors, not credit unions. Furthermore, capital is intended to represent an ownership over resources, and unlike Central 1 or Stabilization Central, CUDIC is a government-owned corporation.

Recommendation #27

The redemption rights for investment, patronage and membership will be amended to better match Basel III standards and continue to treat these shares as tier 1 capital.

Under Basel III, BC credit union membership shares may not be considered tier 1 capital as they may not have sufficient permanency, given that the CUIA requires credit unions to redeem membership shares when a member withdraws their membership and authorizes credit unions to redeem other equity (investment) shares by a resolution of directors.

While the Basel Committee intended to allow cooperative shares with a high degree of permanence and the ability to absorb losses to qualify as tier 1 capital, it did not provide many details about how this would work.⁸ The World Council of Credit Unions recommends regulators follow the approach taken by the European Union, which would treat cooperative shares as tier 1 capital if they are not redeemable or have significant restrictions on their redemption, can absorb losses on a going-concern basis, and meet other similar requirements (such as being accounted for as "equity").

⁸ World Council of Credit Unions, Inc., *Credit Union Shares as Regulatory Capital Under Basel III*, August 2012.

Amending the redemption rights for investment, patronage and membership shares to better match Basel III standards would allow credit unions to continue to treat these shares as highest quality (tier 1) equity as BC moves towards a more modern capital regime based on the Basel III framework.

Liquidity Requirements

Recommendation #28

Adopt Basel III-like liquidity framework and guidance/rules-based approach for liquidity standards.

All new rules would be subject to consultation and Ministerial approval.

A move from prescriptive to more principles-based liquidity regulation (like Basel III) would be in keeping with national and international best practices.

While Basel III requirements could be implemented by regulation, a guidance/rules-based approach is recommended because prescribed quantitative liquidity requirements are inflexible and cannot be adjusted in a timely fashion to mitigate risk and emerging concerns. A guidance/rules-based approach for credit union liquidity standards would permit FICOM to be more consistent with its provincial regulatory counterparts and be more flexible and reactive to emerging concerns. Furthermore, a guidance/rules-based approach would ensure sufficient flexibility to tailor standards to credit unions of different size and complexity.

Recommendation #29

Allow credit unions to hold less than 8 percent statutory liquidity with the approval of FICOM (if and when Basel III-like liquidity standards are adopted, as set out in Recommendation #28).

If Basel III-like targets are adopted, as set out in Recommendation #28, BC credit unions' liquidity will be managed in accordance with international standards. Canadian banks and other international financial institutions that are subject to this framework are not subject to an additional requirement to hold a prescribed percentage of deposits as statutory liquidity.

However, Basel III-like standards have not previously been applied in the BC credit union context and until they have stood the test of time as an appropriate liquidity backstop, it may be prudent to maintain some features of the current regulatory framework, keeping in mind that some BC credit unions have asked for greater scope to set their own liquidity policies. The recommendation is therefore to allow credit unions the option of either following the prescriptive

8 percent requirement or preparing and filing their own liquidity policy with FICOM for approval.

Recommendation #30

Allow credit unions to hold their liquidity outside of the Mandatory Liquidity Pool (MLP) with FICOM approval.

Credit unions currently have the option to continue under federal jurisdiction, in which case they would not be required to hold their liquidity in the MLP. Risks created by making the MLP optional (which may ultimately lead to a smaller pool) can be mitigated by requiring credit unions to submit their proposals to manage their own liquidity to FICOM for approval before leaving the MLP. In addition, to acknowledge the benefit of pooled liquidity and recognize Central 1's compliance with FICOM's risk guidelines, deposits held at Central 1 could be treated more favourably than liquid assets held elsewhere, which may provide an incentive for the credit union system to collectively maintain a sizable liquidity pool.

Consumer Protection

Recommendation #31

Expressly authorize the credit union system to adopt a consumer code of conduct. If the credit union system does not adopt a code of conduct within a reasonable period of time, FICOM may establish a code of conduct for credit unions, with prior public consultation and Ministerial approval.

This proposal would allow the credit union sector to adopt a consumer code of conduct that would address both corporate culture (e.g., fair treatment of consumers) and specific consumer protection issues (e.g., it could require notification of branch closures, mandatory government cheque cashing obligations, annual reporting on consumer and member complaints received by the credit union). The adoption and future amendment of the code would require FICOM approval. FICOM would also have authority to monitor credit union compliance with the code.

While the credit union sector generally does not present major consumer protection concerns, two factors might support some increased attention on consumer protection issues: growth in credit unions, both in membership and business lines; and developments in international/national standards that increasingly focus on market conduct. Moving proactively in this area may be prudent to ensure the framework continues to be effective and maintains public confidence.

The establishment of a set of expectations for fair conduct in the credit union sector would be consistent with Saskatchewan, where the central credit union has adopted and requires adherence to a Market Code Handbook, and with Quebec, where the regulator has issued a set of guidelines

that elaborate on a legislative requirement for credit unions to use sound commercial practices. It would also generally be consistent with the federal government’s intention to establish a set of market conduct provisions within the *Bank Act*.

Recommendation #32

Require credit unions to have in place internal complaint resolution procedures; any complaints not resolved could be taken by the consumer to an ombudservice administered by Stabilization Central.

Notwithstanding the lack of concerns raised about consumer protection, the growth of credit unions along with developments in international/national standards suggest a proactive approach to consumer protection is warranted.

This proposal would provide a formal dispute resolution process to which FICOM and government could direct consumer complaints. An ombudservice could also help address concerns members have as owners, namely issues related to a credit union's organizational or corporate practices (e.g., annual general meeting processes, election and voting practices, board of directors’ decisions).

Recommendation #33

Expressly authorize credit unions to use trade names, including regional trade names; provide regulation-making authority to prescribe notification and other requirements.

Under this proposal, the CUIA would expressly permit the use of multiple trade names by a credit union, including regional trade names. Regulations would prescribe requirements for credit unions using them. Where multiple/regional trade names are used, credit unions would be required to clearly identify the relationship to the credit union (e.g., by using specific wording such as “a division of”). Regulations could also require specific notifications to members of credit unions where multiple/regional trade names are used, to help ensure they are aware of their rights (voting, etc.).

This proposal would expressly provide credit unions with flexibility in branding, helping them to compete in the highly competitive financial sector and to retain goodwill after a merger or acquisition.

Credit Union Governance

Recommendation #34

Make the following changes for member proposals:

- (a) Adopt member proposal provisions, consistent with other Canadian jurisdictions, to allow a single member to bring forward any matter for discussion at an annual meeting.**
- (b) Increase thresholds for requisitioning of special meetings and members' special resolutions.**

Under this proposal, the CUIA would be amended to adopt member proposal provisions whereby a single member can bring forward “any matter that they propose to raise at an annual meeting.” Under these provisions, management would be required to circulate a copy of the proposals to all members prior to the annual general meeting and to allow time for discussion of the proposals at the meeting.

However, if the proposal involves something more than the discussion of a matter at a meeting, such as a members' special resolution or the election of directors, a higher threshold of 1 to 5 percent of members (depending on credit union size) would be required, unless the credit union bylaws provide for a lower threshold. Specifically, the proposal would set the threshold at 5 percent for the first 6,000 members, plus 1 percent of additional members. This same threshold would be required for the extra-ordinary event (and cost) of requisitioning a special meeting of members. Additional restrictions could be adopted, such as a minimum membership period and a prohibition on proposals used to secure publicity.

For smaller credit unions (6,000 members or fewer), this proposal would maintain the status quo (5 percent of members needed to bring forward binding resolutions or requisition special meetings). For larger credit unions, the number of members required would increase from the current level (300), with the exact threshold varying by the size of the credit union (i.e., 1 percent of members or roughly 5,000 members at the largest credit unions). This would effectively set a threshold ranging from 5 percent for very small credit unions to 1 percent for very large credit unions.

This change would respond to the concern of credit unions that the current 300 member threshold does not appropriately reflect the growth in credit union membership.

Recommendation #35

Authorize FICOM to issue binding corporate governance rules, with prior public consultation and Ministerial approval.

Under this proposal, legislation would authorize FICOM to supplement the statutory framework with rules on corporate governance, such as board responsibilities for director elections, supervision of management and enterprise risk management. Further directions on voting processes for the election of directors or more clarity around endorsements of nominees could be provided in FICOM rules.

Clear authority to issue binding corporate governance rules would confirm regulatory/public interest in good corporate governance. Compared to legislative requirements, FICOM would have more flexibility to keep the standards up to date to reflect changes in the environment or in business practices and to allow it to respond to emerging risks. Requiring FICOM to conduct public consultations and to receive Ministerial approval prior to establishing rules would help assure credit unions that any new rules are appropriately balanced; for example, that proportionate rules apply to smaller credit unions.

Recommendation #36

Require credit unions to obtain prior FICOM approval for prescribed types of major transactions and establish criteria that FICOM must take into account.

Currently, FICOM approval is needed only for transactions that involve corporate structural changes (e.g., mergers or continuances) or that raise concerns about conflicts involving transactions with related parties.

This proposal envisions that the FIA would require credit unions, including central credit unions, to obtain FICOM approval for certain prescribed transactions. For example, regulations could require prior FICOM approval of any business acquisition or investment above 1 percent of a credit union's assets and/or \$100 million.

A new regulation-making authority could also be adopted to allow government to set out criteria that FICOM may or must take into account before consenting to all or specific types of major transactions (e.g., that FICOM should consider whether, or be satisfied that, appropriate member input is sought on a type of transaction).

These changes would address FICOM's concern that it does not have appropriate oversight over certain major transactions and that its current broad discretion leaves it unclear about the key criteria that should be considered when approving or rejecting major transactions. Setting out clear criteria would also make the process more transparent for credit unions.

Recommendation #37

Make common bonds optional.

For some BC credit unions that are no longer effectively limited by a geographic or other bond, the common bond requirement is seen as an outdated practice that does not reflect their current business. The credit union system submission recommended that the legislation be amended to allow, but no longer require, a credit union to have a common bond, reflecting rules in some other provinces and the new reality of online banking and increased mobility of members.

Under this proposal, credit unions could amend their constitution to remove the common bond, requiring both member and FICOM approval. Therefore, FICOM could seek assurance at the time of proposed elimination of the bond that a sound risk governance framework is in place to demonstrate that the credit union has the capacity to take on risks outside of its current region or demographic.

Recommendation #38

Make technical changes to credit union governance rules.

Specific technical changes include the following:

- (a) Allow a credit union to alter any part of its constitution by special resolution and with FICOM approval;
- (b) Allow unincorporated associations (e.g., local Toastmaster Clubs), to be members of credit unions;
- (c) Allow credit unions to issue shares in series, with rules and rights similar to business corporate law;
- (d) Allow a credit union member to be able to vote individually as well as on behalf of a business wherein they are sole proprietor;
- (e) Eliminate signature requirement for credit union members requisitioning of special meetings and special resolutions;
- (f) Require credit union directors to appoint all senior officers (including president, vice president, the secretary, the treasurer or the general manager of the corporation); and
- (g) Expand the authority of financial institution's investment and lending committees to review all risks (credit, operational, etc.).

The technical changes listed above respond to some of the requests made by credit unions (e.g., allowing unincorporated entities to be members of credit unions) and generally modernize the governance framework for credit unions.

Central Credit Unions

Recommendation #39

Direct FICOM and Stabilization Central to develop a Memorandum of Understanding (MOU) delineating their respective roles and setting out the circumstances in which FICOM will delegate supervisory authority to Stabilization Central.

Credit unions have concerns that there is uncertainty over the role of Stabilization Central and that Stabilization Central is underutilized. If the responsibilities and role of Stabilization Central were better defined, FICOM could make better use of Stabilization Central and its resources.

While credit unions recommended an enhancement of Stabilization Central's statutory powers, including the transfer to Stabilization Central of many of those powers currently exercised by FICOM and even CUDIC, credit unions are a significant and growing component of the financial services sector and external oversight is important. A move to greater self-regulation, with a corresponding reduction in the external oversight of credit unions by an independent regulator, may raise public policy concerns in light of the significant importance of deposit-taking institutions to the economy.

Regulators and industry self-regulatory bodies must work together to function effectively and an MOU would provide the starting point for an effective partnership between FICOM and Stabilization Central.

Recommendation #40

Continue to provide Central 1 with the broad business powers currently set out in the CUIA but amend the legislation to clarify that credit unions, including central credit unions, must obtain prior FICOM approval for prescribed types of major transactions.

The CUIA currently provides substantial flexibility for Central 1, allowing it to adapt to changes in the credit union system provided its functions meet the test of being incidental or conducive to the sound operation of its members or to the attainment of the purposes of its members.

Prior to January 2017, Central 1 was jointly regulated by BC (FICOM) and federal (OSFI) regulators, and, in addition to the FIA and CUIA, was subject to provisions in the federal *Cooperative Credit Associations Act* (CCAA) and numerous OSFI guidelines. In January 2017,

FICOM became 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. As well, the FIA was developed prior to Central 1 having an expanded role as the credit union system's payments and clearing provider and supporting credit unions outside the province. Under this proposal, Central 1 would need to obtain prior FICOM approval for major transactions, such as major business acquisitions and taking on the functions of another province's central. FICOM's current broad discretion with respect to approving major transactions leaves it unclear about the key criteria that should be considered when making decisions. Setting out clear criteria for the approval of major transactions would help to provide transparency about the process.

Recommendation #41

Set out a legislative framework for the designation of provincial financial institutions as Domestic Systemically Important Financial Institution (D-SIFIs) and enable FICOM to issue enforceable guidelines applicable to D-SIFIs, as appropriate.

The Basel Committee noted that regulatory authorities should establish a methodology for assessing the degree to which financial institutions are systemically important in a domestic context.⁹ Central 1, which has been designated as a D-SIFI by FICOM, has expressed concern about the lack of a legislative framework for regulating D-SIFIs.

Under this approach, the authority for FICOM to designate a D-SIFI would be set out in the FIA, along with the qualifying criteria and requirements. The qualifying criteria and requirements would be similar to those recommended by the Basel Committee, but adapted to the credit union system.

In light of OSFI ceasing its oversight of Central 1 in 2017, FICOM would also be provided the authority to issue enforceable guidance to Central 1 (or any D-SIFI) to clarify requirements and update standards, as needed, to reflect current market conditions, emerging risks and evolving regulatory practice. FICOM-issued guidelines would be subject to consultation and Ministerial oversight.

⁹ Basel Committee on Banking Supervision, *A framework for dealing with domestic systemically important banks*, October 2012.

Technology

Recommendation #42

Adopt reforms to member communication and AGM notice requirements to allow notices to be sent electronically, and amend the legislation to use technologically neutral language.

Under this proposal, the requirement to mail notices would be eliminated and instead credit unions would be permitted to provide notice to members by email (if a member has provided an email address) and by notice in newspapers or on the credit union website. The approach would be optional for each credit union and the credit union's rules would have to be amended, with member support, prior to any change.

Credit unions undertake business in one of the most competitive sectors in Canada, and outdated rules in financial institutions legislation should not impede their ability to compete. Older framework rules, particularly the requirement to deliver AGM notices by mail, impose both environmental impacts and financial costs, and are inconsistent with member and consumer needs and expectations. Furthermore, modern corporation laws, including the *Business Corporations Act* and the new *Societies Act*, provide entities significant flexibility in communicating with members.

The credit union system recommended the legislation be re-written in technologically neutral language, which would be consistent with the approach established under the *Electronic Transactions Act* where a document that must be provided in writing to another person may be provided electronically if the recipient consents.

Recommendation #43

Provide FICOM with the authority to issue binding rules on records storage, with prior public consultation and Ministerial approval.

Currently, there is some concern that the regulator may experience problems accessing records of credit unions and other financial institutions, particularly in the event of a credit union failure, which could undermine deposit insurance protection and market confidence.

Adopting a guidance/rules-based approach to record storage is preferred to amending legislation to prohibit or restrict specific practices, as it will provide more flexibility and responsiveness as business conditions change over time.

INSURANCE SECTOR

Insurance Retailing and Licensing Exemptions

Recommendation #44

Expand the restricted licensing regime currently applied to travel agencies to other incidental insurance sales, similar to the approach used in Alberta, Saskatchewan and Manitoba.

Insurance products are generally sold by licensed agents who provide advice and help consumers to understand the products they are purchasing. 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 that covers a good or service the consumer is acquiring from the seller (e.g., product warranties for electronics and appliances, credit insurance sold incidentally to the arranging of credit by a financial institution).

Many of the products sold by exempt sellers, especially travel insurance and credit insurance, have received significant negative press coverage in recent years. As well, the products sold by exempt sellers have increased in complexity and coverage amounts.

Under this proposal, certain entities would be required to obtain a restricted licence that would allow the entities to sell insurance where it is sold incidentally to their ordinary business (e.g., motor vehicle warranty insurance, credit insurance). This licence would be a corporate licence issued to the business entity, which would be responsible for the insurance activities of its employees. This model is already in place for travel agencies selling travel insurance in BC and is also the model used by Alberta, Saskatchewan and Manitoba for the sale of credit insurance, travel insurance, funeral insurance, etc.

A restricted licensing regime would allow for oversight and enforcement related to incidental sales of insurance, which is important as these insurance products increase in complexity and value. This option would also allow specific requirements to be adopted if necessary, such as the requirement for education for persons selling certain insurance products.

Recommendation #45

Provide FICOM with the authority to issue guidelines requiring insurers to provide more direct oversight of exempt sellers and/or sellers under a restricted licensing regime.

Exempt sellers of insurance products are not necessarily accountable to regulatory bodies and are also generally not under the direct oversight of the insurer. One way of increasing oversight of exempt sellers is to increase the accountability of the insurer whose product they sell, for example by requiring insurers to provide training or guidance to exempt sellers.

Under this proposal, the legislation would authorize FICOM to issue enforceable guidelines that set out how insurers must oversee exempt sellers and/or sellers under a restricted licensing regime. The guidelines would be subject to public consultations and ministerial approval.

Recommendation #46

Maintain the current regulatory oversight of the insurance activities of travel agents.

The Insurance Council suggested that regulatory requirements could be streamlined by allowing the insurance activities of travel agents (and funeral directors) to be regulated by their principal regulator, Consumer Protection BC. However, travel insurance is available through a number of entities, not just travel agents. Having Consumer Protection BC regulate the sale of the travel insurance by travel agencies, but not the sale of travel insurance sold by other entities, may result in confusion for consumers.

Recommendation #47

Place restrictions on the sale of insurance products sold on a post-claims underwriting basis by exempt sellers and/or sellers under a restricted licensing regime.

Insurance sold on a post-claims underwriting basis means that eligibility for insurance coverage is determined after a claim is made. It is commonly used for credit insurance products sold by exempt sellers and is conducive to quick enrolment (which benefits consumers by reducing transaction time and inconvenience), but leads to enrolment of some consumers who are not actually eligible for coverage.

Implementation of this proposal would place restrictions on the sale of insurance products sold on a post-claims underwriting basis, without actually prohibiting their sale entirely. This

proposal balances necessity of access to insurance and the risk of consumers finding out they are ineligible for insurance sold on a post-claims underwriting basis after they need it.

Restrictions could include some or all of the following:

- Require education of salespersons so they are better able to advise the consumer about the meaning and importance of health questions and disclosure;
- Require specific point-of-sale disclosures or specific, standardized wording of health questions to ensure consumers are able to understand their obligations; and/or
- Prohibit the denial of claims based on any innocent misrepresentation in respect of credit insurance sold under a licensing exemption (that is, other than by a licensed agent).

Consumer Protection

Recommendation #48

Require insurers to treat consumer fairly; delegate authority to FICOM to develop a code of conduct for insurers and to develop rules based on the code.

The establishment of a code of conduct for insurers would be consistent with international standards and would parallel the establishment of a code of market conduct for the BC credit union sector (as described in recommendation 31). This model allows specific guidance to evolve along with emerging issues in a more dynamic way than legislation typically permits.

Because insurance companies often operate in multiple jurisdictions, consistency is important. Ideally the Canadian Council of Insurance Regulators (CCIR) would develop a national code of conduct for insurers that FICOM could adopt. Otherwise, FICOM could look to existing national industry codes/standards as much as possible to avoid inconsistencies with other jurisdictions. Both the code and any accompanying rules would be subject to ministerial approval and public consultation.

The code and any accompanying rules would apply only to insurers. The Insurance Council of BC would continue to administer the existing Code of Conduct for agents and brokers in BC.

Recommendation #49

Do not require mutual insurers to have membership in an ombudservice.

No issues or consumer complaints have arisen that would appear to justify eliminating the ombudservice exemption provided to mutual insurers (which stems from their cooperative nature). Mutual insurers can continue to voluntarily offer their policyholders access to an independent ombudservice, as Mutual Fire Insurance of BC currently does.

Recommendation #50

Do not require insurance agents/brokers to have membership in an ombudservice.

The CCIR recently undertook research on a potential nationwide dispute resolution mechanism for disputes between licensees (agents/brokers) and consumers that would be shared across jurisdictions. This research has indicated there are not enough cases to warrant a separate body. The CCIR concluded that errors and omissions insurance should continue to be relied upon (where applicable) to compensate consumers in the event of a loss.

In the absence of an ombudservice, consumers could continue to seek a resolution via the legal system, including the new Civil Resolution Tribunal (currently for disputes involving amounts under \$5,000). In BC, insurance licensees are required to have errors and omissions insurance, helping ensure compensation is available to those consumers who pursue legal remedies. In addition, consumers can continue to file complaints against agents/brokers with the Insurance Council of BC.

Protection of Confidential Information

Recommendation #51

Provide privilege for the self-assessment programs of financial institutions (insurance companies, credit unions, trust companies).

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.

Concerns have been raised that confidential information provided to regulators 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.

Under this proposal, the FIA would be amended to include a provision protecting self-assessment documents prepared by financial institutions (i.e., insurance companies, credit unions, trust companies) from disclosure. These documents would also no longer be accessible under the *Freedom of Information and Protection of Privacy Act* (FOIPPA). However, the legislation would make clear that credit union members and mutual insurer policyholders are still able to access information about their respective financial institutions so they are able to exercise their rights as owners.

This proposal would make BC consistent with the approaches in Alberta, Saskatchewan and Manitoba, which all provide privilege for the self-assessment programs of insurance companies. This proposal is also consistent with recommendations made by the CCIR.

Recommendation #52

Allow FICOM to withhold information under the *Freedom of Information and Protection of Privacy Act* (FOIPPA) when it is provided by other regulators in confidence.

The financial institutions sector in BC is comprised of local and national companies, which means that FICOM must cooperate with other regulators such as the federal regulator in order to oversee them. Currently, other regulators are reluctant to share information about financial institutions with FICOM because information protected in their jurisdiction may be released in BC subsequent to a freedom of information request made under FOIPPA.

This proposed change would be consistent with the approaches taken federally, in Alberta and in Saskatchewan and would facilitate FICOM sharing information with, and receiving information from, other provincial and federal regulators.

Regulation of Insurance Intermediaries

Recommendation #53

Continue to have all Insurance Council members appointed by the LGIC.

While a change to a combined elected/appointed model is strongly supported by industry, the Insurance Council, as currently structured, has proven to be an effective and balanced regulator of the sector. No concerns about the competency of the members or a lack of focus on consumer protection have been raised. Concerns raised about insurance agent conduct appear to be addressed effectively and efficiently, and at the same time, industry participants seem to feel the Insurance Council regulation is appropriately balanced and not unfairly burdensome.

Moreover, the current approach is consistent with legislative reforms made in 2016 with respect to the structure of the Real Estate Council to ensure appropriate protection of the public.

Recommendation #54

Expand the number of Insurance Council members appointed by the LGIC from eleven to thirteen by adding two additional independent agent representatives.

Under this proposal, the number of Insurance Council members from each of the independent general and life insurance brokers and agents would be increased from two to three, while the other categories of representatives would not change.

Increasing the number of representatives of independent insurance agents would promote effective and representative regulation of insurance intermediaries.

Recommendation #55

Implement technical changes to Insurance Council tools and powers as identified by Council and Ministry of Finance staff.

Under this proposal, a number of largely technical changes to the tools and powers of the Insurance Council would be made. Proposed changes include:

- (a) Giving a hearing committee the authority to decide a matter, not just prepare a report to Council;
- (b) Increasing maximum fines that may be imposed by the Insurance Council from \$10,000 for individuals and \$20,000 for corporations to \$25,000 for individuals and \$50,000 for corporations and partnerships;
- (c) Allowing Council to assess investigation costs even where no other disciplinary action is warranted (any such investigative costs order would remain subject to appeal to the Financial Services Tribunal);
- (d) Clarifying that Council may publish its decisions on its website or other websites; and
- (e) Replacing the current provision on Council member remuneration (currently based on a specific LGIC order) with a provision linking remuneration to Treasury Board policies (consistent with other government boards).

While the Insurance Council has operated successfully with the current sets of tools and no major concerns have been raised, adopting these generally minor changes will enhance consumer protection and Insurance Council effectiveness. These proposed changes are consistent with tools and powers available to other self-regulatory bodies.

Recommendation #56

Maintain the current framework for special brokers.

Special brokers in BC are licensed and regulated by the Insurance Council and must also abide by government regulations requiring additional reporting to FICOM. This review considered whether to require special brokers to obtain a separate licence from FICOM, similar to the requirement in several other provinces for these brokers to be licensed directly by the financial institutions regulator or government.

However, in BC the risks associated with special brokers are already addressed in several ways. To ensure the agent's capacity, the Insurance Council requires prior notice to Council before an agent undertakes this type of business. The FIA prohibits special brokers from directly or indirectly soliciting residents for this insurance business and requires quarterly reporting to FICOM.

Technology

Recommendation #57

Draw on the CCIR's recommendations to put in place a flexible legal framework that enables insurers to offer their products online while protecting consumers.

Many consumers, particularly younger, tech-savvy consumers, use online information and sales to save time, have more control of the process, research different options, etc. For some consumers, the ability to read about a policy and coverage quickly and efficiently online is preferable to traditional purchases where the consumer has to rely primarily on the information an agent provides.

Insurers, and many insurance agents and brokers, want to be able to respond to consumer preferences, provide information and solicit insurance business using new technology. It is likely that increased consumer comfort with online sales, along with competition and cost pressures, will eventually lead to increased use of the internet by insurers and their customers.

Under this proposal, the recommendations made by the CCIR in relation to electronic commerce would be used to develop a flexible legal framework that expressly enables insurers to offer products online while protecting consumers.¹⁰ For example, online insurance providers could be required to ensure consumers purchasing an insurance product make informed decisions by:

¹⁰ Canadian Council of Insurance Regulators (CCIR), *Electronic Commerce in Insurance Products*, http://www.ccir-ccra.org/en/init/Elec_Commerce/ECC_position_paper_2013_EN_final.pdf, May 2013.

providing them with the information needed, in a timely and comprehensive way; providing them with access to a suitable level of advice, taking into account, among other factors, the complexity of the product; and making consumers aware of the importance of obtaining advice.¹¹

Recommendation #58

Do not prohibit the promotion of insurance on credit union websites.

It is not clear that concerns addressed by the current prohibition on credit unions and insurance agencies sharing the same premises (i.e., coercive tied selling and sharing of confidential information) are relevant to web-based insurance promotions. Practically, credit union involvement in insurance has been significantly reduced in recent years.

Long-term Disability Plans

Recommendation #59

Pending further consultation, require employee long-term disability (LTD) plans to be insured, with exemptions for certain employers with low risk of insolvency.

Employee benefit plans are exempted from regulation under the FIA (employee benefit plans generally fall within the province's definition of insurance and, but for the exemption, would be subject to regulation under the FIA). No concerns have been raised about this exemption in respect of uninsured short-term benefits such as health and dental benefits or short-term illness/sick pay. However, because of the enormous financial hardship for individuals that can result from the loss of LTD coverage, concerns have been raised about the current exemption in the context of LTD coverage.

Uninsured employer LTD plans may not be available to support claimants in times of corporate financial stress or insolvency. Confusion on the part of the employee can arise, especially where an "administrative services only" (ASO) arrangement is in place (an ASO arrangement is where an insurance company has been contracted to administer the program, but the employer retains the underlying risk). Employees dealing with a licensed insurer for any claims may be surprised

¹¹ The Government of Quebec recently introduced legislation proposing extensive reforms to its financial services sector legislation. This proposed legislation includes new provisions aimed at addressing online sale of insurance by insurance companies and distributors. For example, see sections 59-68 of the proposed new *Insurers Act*, as enacted by s. 3 of Bill 141, *An Act mainly to improve the regulation of the financial sector, the protection of deposits of money and the operation of financial institutions*.

after the company's failure to learn that they do not have a claim against the insurer, but only against the failed company.

Under the proposed amendment, employers that choose to offer LTD benefit plans would be required to do so using an authorized insurance company rather than retaining the underlying risk themselves.¹²

While employers are currently required to disclose in writing if benefits are not insured and the plan sponsor is not subject to insurance regulation, in practice, many employees likely continue to be uninformed or confused about who is responsible for their LTD benefits.

This proposal is consistent with federal law and with recent changes in Ontario (not yet in force). Ministry staff will conduct further consultation with the business community and labour unions to better understand the use of self-insurance and ASO plans in the private sector and in negotiated labour agreements.

Rebating

Recommendation #60

Cap rebates at the lesser of 25 percent of the initial year's commission and 25 percent of the initial year's premium.

In 2004, the FIA was amended to allow rebating but capped the amount that may be rebated to 25 percent of the premium. Government agreed to monitor the impact of the new rebating rule on the industry to determine whether changes are required.

The proposed amendment is intended to refine the current compromise position by making an adjustment to account for the differing commissions earned by life insurance sellers and property and casualty insurance sellers (who typically earn less than 25 percent of the premium as a commission). The goal is to bring the legislation into greater alignment with the original intent of the cap.

¹² The Insurer Exemption Regulation currently includes in the definition of "employer" groups of employers, unions and groups of unions, and entities formed by an employer to provide benefits to employees.

Recommendation #61

Continue to allow insurance licensees to make referral payments but require them to disclose the amount of any referral payment.

Current regulatory trends in the financial sector favour enhanced transparency for consumers. Enhancing referral commission disclosure requirements would be consistent with other changes recently planned/implemented for BC's financial sector framework, including requirements governing the disclosure provided by mortgage sellers and mutual fund dealers.

Regulation of Reciprocal Exchanges, Mutual Insurers, and Societies

Recommendation #62

Enhance the regulatory framework for reciprocal exchanges.

While no specific concerns have been raised about the operation of reciprocal exchanges in BC, the more limited regulatory requirements and tools available to FICOM to oversee these entities could pose some risk to insured persons and the public. FICOM believes the regulatory framework for reciprocals should be more closely aligned with the more robust frameworks in other provinces (Alberta, Saskatchewan, Manitoba and Ontario).

This proposal will require further consultation with industry to determine the best framework for reciprocal exchanges in BC.

Recommendation #63

Maintain the current framework for regulating mutual insurers (i.e., do not establish a demutualization framework).

Across Canada, the biggest legislative reform issue for mutual insurers is demutualization. Both Ontario and the federal government have adopted legislation to allow mutual insurers to demutualize (i.e., become a regular insurance corporation that is owned on a business corporate law rather than cooperative law basis). However, no mutual insurers in BC have expressed an interest in demutualization.

Recommendation #64

Eliminate the “deemed business authorization” category for societies and apply the full insurance company framework to these entities.

Since 1990 the FIA has included a broad prohibition on any society obtaining a business authorization to conduct insurance business. A few existing societies (already licensed under previous legislation) were deemed to have a business authorization under the FIA. These societies are referred to as “deemed business authorization societies” and are subject to certain provisions of the FIA. Some other societies offering limited types of coverage that had been exempted from legislation prior to 1990 were provided with an exemption in 1990 and are referred to as grandfathered societies (grandfathered societies are exempt from the FIA entirely). While it appears that many grandfathered societies that offered insurance prior to 1990 still offer limited accident and sickness benefits to members of their organizations (e.g., sports organizations offering limited dental care and business trade organizations offering limited accident and sickness coverage to employees of member companies), no concerns have been raised with the government or the regulator about the operation of these entities.

With respect to “deemed business authorization societies”, FICOM has recommended eliminating this category and applying the full framework to the few societies in this category (i.e., Pacific Blue Cross and federally-regulated fraternal associations). The proposed change would enhance regulation of key insurance entities and would help maintain public confidence in them. Further consultation with affected entities will be required to assess whether there will be any major impacts from the changes and whether/what exemptions may be required.

TRUST SECTOR

Provincial Authorization/Regulation of Trust Corporations

Recommendation #65

Do not make changes to the FIA pertaining to authorization or filing for trust corporations.

This review examined the possibility of eliminating the authorization requirement on the basis that (trust-only) trust corporations do not carry the same types of risks as deposit-taking institutions. However, it was concluded that authorization plays an important role as the authorization requirement is the only way BC can ensure that only qualified trust corporations operate in the province. Authorization also provides a useful mechanism for enforcing the FIA's consumer protection provisions.

Unincorporated Trust Business

Recommendation #66

Do not amend the FIA to regulate unincorporated trust business (by individuals or other unincorporated entities).

Some stakeholders have expressed concern that vulnerable adults and others need to be protected from unincorporated trust services businesses that have no insurance, oversight, or trained staff. However, other than certain professionals (e.g., lawyers, who are trained and insured) and businesses offering employee health benefit trusts, there appear to be few or no such businesses in operation in BC. Government is not aware of any consumers who were harmed by an unregulated individual or other entity offering trust services to the public.

Furthermore, the risks associated with unregulated trust business are already mitigated by several mechanisms. All trustees (including trust businesses) must abide by the *Trustee Act* and the common law in respect of their duties as trustees. Even in the absence of a prohibition on unincorporated trust business, beneficiaries will continue to have access to civil remedies in the case of financial abuse or if a trustee fails to perform their duties to the high standard required by trust law. Finally, the criminal law will continue to apply where a consumer is defrauded or financially abused by an individual or other entity offering (or claiming to offer) trust services.

Maintaining the status quo (i.e., not regulating unincorporated trust businesses) is consistent with all other Canadian jurisdictions.

Self-dealing

Recommendation #67

Do not introduce new regulation of self-dealing by trust companies but broaden section 93(1) of the FIA to enhance consumer protection.

As part of this review, a concern was 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 is not the role of the FIA, the issue examined was whether there should be additional regulatory oversight to deal with potential conflicts of interest (and in particular, self-dealing, which refers to transactions not made at arm’s length).

Enhancing regulation of self-dealing might be achieved by either prohibiting self-dealing or by mitigating its impact on consumers, as is done in some other jurisdictions including the United States. However, an attempt to regulate self-dealing would have many complex implications given that this is an area of the law that overlaps with securities regulation, trust law, and banking regulation (and may, in fact, be more appropriately addressed by one of these regimes). Regulating self-dealing may also impact federally-regulated financial institutions in ways that potentially overstep provincial jurisdiction.

An ancillary issue was raised during the analysis of this topic. Section 93(1) of the FIA provides authority for FICOM to prohibit the use of a contract between a financial institution and its customers (or an application/advertisement relating to a contract) if it is unfair, misleading, or deceptive. The references in the provision to “contracts”, applications and advertisement may not encompass all materials in use by financial institutions. For example, an issue that has arisen is whether section 93(1) applies to explanatory material provided by financial institutions (e.g., brochures). Broadening the wording of s. 93(1) would help clarify that the provision applies to all aspects of a consumer transaction, including, where applicable, a trust instrument and materials provided to consumers for informational purposes.

Capital Requirements

Recommendation #68

Do not change capital requirements for trust companies.

The 0.5 percent capital requirement for provincial trust-only trust companies has been in place since the adoption of the FIA in 1990.

Although a risk-based capital regime for BC trust companies was considered, the activity of BC trust companies is largely trust services (versus riskier activities such as lending), so no change is being proposed at this time.

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).

“Canadian Council of Insurance Regulators” is an inter-jurisdictional association of insurance regulators. The mandate of the CCIR is to facilitate and promote an efficient and effective insurance regulatory system in Canada to serve the public interest.

“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.

“D-SIFI” is a domestic systemically important financial institution. D-SIFIs are financial institutions whose disorderly failure could cause significant disruption to the wider financial system and economic activity.

“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.

“MLP” is the Mandatory Liquidity Pool held by Central 1 Credit Union. All BC-incorporated credit unions are required to hold liquidity in the MLP. Some Ontario credit unions also hold liquidity in the MLP.

“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.