Review of the *British Columbia Financial Institutions Act* and *Credit Union Incorporation Act*

Submission to the Ministry of Finance

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ASSOCIATION DES BANQUIERS CANADIENS | CANADIAN BANKERS ASSOCIATION

EXPERTISE CANADA BANKS ON
LA RÉFÉRENCE BANCAIRE AU CANADA

The Canadian Bankers Association (CBA) is pleased to have the opportunity to present the views of the banking industry as part of the review of both the *Financial Institutions Act* (FIA) and the *Credit Union Incorporation Act* (CUIA).

The CBA works on behalf of 60 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 280,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness.

The CBA believes that a strong financial system, based on sound internal risk management and an effective prudential policy, supervisory and regulatory framework, is vital to the Canadian economy. The credit union system is an important part of Canada's dynamic financial sector, contributing to the choice and competition available to consumers.

As the global financial crisis demonstrated, disruption to the financial sector can spread quickly, even to institutions that would consider themselves immune. As a result, it is important that all financial institutions, credit unions as well as banks, operate within a robust prudential policy, supervisory and regulatory framework to ensure the continued safety and soundness of Canada's financial system as a whole.

As British Columbia is home to the largest credit union system in Canada outside of Quebec, prudential policy, supervisory and regulatory framework for credit unions is particularly important to the province. Credit unions play a significant and systemically important role in the province of British Columbia with assets over $60 billion and deposits exceeding $54 billion[1]. The province is also home to some of the largest credit unions in the country, with three credit unions ranking in the top 10 nationally by asset size and representing about 60% of all credit union assets in the province.

Credit Union Sector

Credit Union Growth and Complexity

Credit unions are increasingly evolving into complex institutions that offer a wide array of products and services that are supported by operations that resemble those of banks. According to B.C.'s Superintendent of Financial Institutions, "credit unions are getting into more bank-like businesses, offering mezzanine financing, large-scale commercial lending, (and) venture-capital lending"[2]. Given the increase in size and complexity of some credit unions, both the Bank of Canada and the International Monetary Fund (IMF) have raised the importance of a robust framework for these

[1] Credit Union Central of Canada, as at December 2014
[2] B.C. Business, http://www.bcbusiness.ca/finance/credit-unions-eye-the-big-time, January 6th, 2014

institutions, particularly as they opt to perform more complex transactions, take on riskier "bank-like" activities or become large enough to pose systemic risks[3].

Some changes have been made to manage the growing complexity and size of credit unions. An obvious example is the 2008 merger between the Credit Union Central of British Columbia and the Credit Union Central of Ontario to create Central 1 Credit Union in order to provide appropriate liquidity and funding services, technology and payments processing, government relations and trade association activities. There have also been discussions regarding additional mergers with other Centrals to support credit unions with scalable solutions that are available on a national basis.

Central 1 is somewhat unique compared to other provincial centrals as its primary regulator is in the Financial Institutions Commission of British Columbia (FICOM), yet it is also accountable to the Deposit Insurance Corporation of Ontario (DICO). Indeed, Central 1 has grown so important given its role in today's market as the primary liquidity manager and payments processor for the two provinces, FICOM recently identified Central 1 Credit Union as a domestic systemically important financial institution (D-SIFI). FICOM recognized that the failure of Central 1 could cause significant disruption to the wider financial system and consequently took steps to enhance supervision and regulatory oversight.

Prudential Policy, Supervisory and Regulatory Framework

Given the growing complexity and size of credit unions, and in order to ensure the safety and soundness of Canada's financial system as a whole, the CBA believes that the credit union movement should operate within a robust prudential policy, supervisory and regulatory framework consistent with that of federally regulated financial institutions. Such a robust framework would include, for example, the large number of initiatives that have been implemented by the federal government and its financial agencies since the global financial crisis. These initiatives include Basel III reforms on capital adequacy and liquidity guidelines, enhanced disclosure, mortgage underwriting practices, corporate governance, and recovery and resolution planning.

The IMF stressed the importance of a robust framework in its 2014 Financial Sector Assessment Program (FSAP), when it remarked that as provincial deposit takers become large enough to pose systemic risks, they should also be subject to the same level of rigorous supervision and regulation as other major depository institutions in Canada[4]. Furthermore, the Deputy Governor of the Bank of Canada indicated that, if provincial governments and regulators fail to adopt requirements such as Basel III and credible recovery and resolution plans, their credit unions are at risk of being labelled shadow banks[5].

In the March 2014 Report on Credit Union Supervision by the Auditor General of British Columbia, several key issues including the importance of pursuing international industry standards were identified. It is encouraging to note that the report recognized that FICOM is working toward

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[3] Financial Sector Stability Assessment for Canada, International Monetary Fund (IMF), IMF Country Report No. 14/29, February 2014 and Canada's Schembri Says Co-op Banks Need Better Risk Controls, Bloomberg News, October 7th, 2014
[4] Financial Sector Stability Assessment for Canada, International Monetary Fund (IMF), IMF Country Report No. 14/29, February 2014.
[5] Canada's Schembri Says Co-op Banks Need Better Risk Controls, Bloomberg News, October 7th, 2014.

meeting the international industry standards outlined by the Basel Committee Banking Supervision (BCBS) guided by a principled, risk-based approach. This being said, for some of the standards, the Auditor General acknowledged that FICOM has gone as far as it can within the existing legislation. The provincial government has the opportunity to use this current review of the FIA and the CUIA to provide FICOM with the necessary powers to fully meet the international industry standards outlined by the Basel Committee[6].

If FICOM chooses not to pursue a similar framework as that of federal regulated financial institutions, these variations should be publicly identified along with an explanation as to why these standards were not applied.

It is also important to ensure there is an appropriate level of supervisory oversight and expertise with the regulator. The IMF's FSAP for Canada noted that some large credit unions require provincial supervisors to have the capacity, on a standalone basis, to effectively supervise them and for the respective provinces to have the fiscal resources to backstop depositors and resolve any nonviable ones in an orderly fashion. Yet this can be challenging because of the wide dispersion of supervisory talent across the provinces[7]. The Auditor General's report highlighted this challenge in British Columbia by noting that FICOM is significantly constrained due to a shortage of staff, particularly in more senior and specialized roles, that is leading to supervisory work being scaled back and stalling the effectiveness of its work[8]. This could lead to a situation where worsening circumstances at a credit union may not be detected in time to address and reduce the risk of failure.

The importance of a strong provincial policy, supervisory and regulatory framework has taken on more significance in light of changes with respect to federal oversight and support of provincial regulated financial institutions. The federal government has taken steps to clarify its mandate with respect to provincially regulated financial institutions which include:

- Ceasing joint supervision of provincial credit union centrals by the Office of the Superintendent of Financial Institutions (OSFI);
- Eliminating possible recourse of provincial deposit protection agencies to Canada Deposit Insurance Corporation (CDIC) loans; and,
- Granting access to the Bank of Canada's Emergency Lending Assistance (ELA) program only to those Centrals and credit unions whose provinces have agreed to provide an indemnity to the Bank of Canada for any losses that may occur as a result of that assistance, as well as having a credible recovery and resolution plan.

As a result of these actions, provincial governments should ensure that they have an appropriately robust prudential policy, supervisory and regulatory framework for credit unions in place as well as the resources to maintain that framework.

[6] Jones, Russ. Office of the Auditor General of British Columbia, Credit Union Supervision in Canada, March 2014.
[7] Financial Sector Stability Assessment for Canada, International Monetary Fund (IMF), IMF Country Report No. 14/29, February 2014.
[8] Jones, Russ. Office of the Auditor General of British Columbia, Credit Union Supervision in Canada, March 2014.

Recommendation: Credit unions should operate within a robust prudential policy, supervisory and regulatory framework harmonized with that of the regime for federally regulated financial institutions. Where provincial supervisors and regulators do not adopt elements of this prudential framework, they should provide an explanation as to why they were not adopted.

Deposit Insurance Guarantee

An important element of a robust prudential policy, supervisory and regulatory framework is a suitably designed deposit insurance system. A deposit insurance system should strike an appropriate balance between depositor protection and market discipline while promoting financial stability.

According to the International Association of Deposit Insurers (IADI), the level and scope of coverage should sufficiently protect the majority of depositors and leave a meaningful proportion of the value of the deposits uninsured[9]. The Financial Stability Board (FSB) has recognized the CDIC's $100,000 guarantee of federally-regulated deposit taking institutions as an example where that balance has been struck between depositor protection and market discipline. The FSB noted that, as of 2010, while CDIC covers an estimated 97% of eligible deposit accounts, this represents only 35% of the total value of deposit liabilities[10]. The total value of deposit liabilities covered by CDIC has been declining since 2010, with insured deposits representing approximately 30% of the total value of deposit liabilities as of 2014[11].

In contrast, British Columbia is one of the provinces that the FSB considered when it stated that unlimited deposit coverage through the complete protection of eligible deposits should be avoided because it could lead to greater risk-taking and adversely affect deposit insurance system effectiveness[12].

The effectiveness of coverage offered by an unlimited deposit guarantee is undermined by moral hazard which is present when depositors and institutional investors do not hold financial institutions' risky actions accountable because they believe they are protected from losses in the event of failure. The IADI noted that excessive risk taking can lead to increased losses to the deposit insurer or taxpayer and a misallocation of economic resources[13].

In an unlimited deposit guarantee environment, the guarantee typically attracts wholesale deposits that can be volatile and can destabilize institutions if withdrawn quickly. Furthermore, there are no uninsured deposits to bear the brunt of a failure. If a provincially-regulated deposit taking financial institution were to fail, the provincial government and ultimately British Columbia taxpayers would be responsible for ensuring that those obligations are met. This obligation is material and growing.

[9] Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage, International Association of Deposit Insurers (IADI), March 2013.
[10] Thematic Review on Deposit Insurance Systems: Peer Review Report, Financial Stability Board (FSB), February 9th, 2012.
[11] CDIC Annual Report 2015.
[12] Thematic Review on Deposit Insurance Systems: Peer Review Report, Financial Stability Board (FSB), February 9th, 2012.
[13] International Association of Deposit Insurers (IADI), Enhanced Guidance for Effective Deposit Insurance Systems: Mitigating Moral Hazard, May 2013.

The amount of insured credit union deposits in British Columbia as a proportion of the provincial government's taxpayer-supported revenues is approximately 120% − up from 96% in 2008, just prior to the increase of the unlimited deposit guarantee limit. To put this growth into perspective, while insured deposits covered by CDIC has grown by 36% since 2008, insured deposits in British Columbia has grown by 49%. To address this issue, placing limits on the amounts insured is an effective means of mitigating moral hazard and lowering the provincial government's risk exposure.

The unlimited deposit guarantee, and the moral hazard that accompanies it, should also be examined within the Canadian context. Deposit insurance regimes in Canada are characterized by competitive distortions that reduce the overall effectiveness of financial stability. Indeed, the justification given for British Columbia's implementation of the unlimited deposit guarantee was a concern that volatile market conditions might direct some deposits into neighbouring provinces which offered full deposit guarantees[14]. In other words, as a result of regulatory arbitrage with the three other western provinces that offered an unlimited deposit guarantee, policymakers in B.C. felt it necessary to adopt a coverage limit that moved the province away from what is considered international best practice and CDIC's coverage level of $100,000. The adoption of the unlimited deposit guarantee in B.C. increased the diversity of Canada's deposit insurance regimes. From a depositors' perspective, this heterogeneity of deposit insurance coverage levels may create uncertainty and confusion[15]. This uncertainty and confusion could also be accentuated by the FIA's "home and host principal regulator" option where depositors in different provinces may be covered by differing coverage levels depending on whether a reciprocal agreement has been signed.

Since the financial crisis, governments internationally have reduced the level of deposit insurance coverage that was instituted during the financial crisis in conjunction with improvements in other areas of prudential policy, supervision and regulation. The same actions should occur in Canada, particularly for provinces with unlimited deposit guarantees such as British Columbia. And while FICOM is taking steps to implement international standards as outlined by the BCBS, an unlimited deposit guarantee is incongruent with best practices as laid out by the IADI and highlighted by the FSB.

Furthermore, when reducing the level of deposit insurance coverage, the heterogeneity of deposit insurance guarantees should also be addressed. Given both the prevalence of CDIC-insured deposits in the Canadian financial system (the CBA estimates that CDIC-insured deposits amount to almost 75% of total federally- and provincially-insured deposits) and the balance that it has struck between depositor protection and market discipline in the promotion of financial stability, coverage levels in the provinces should be uniform and consistent with that of CDIC[16]. This would improve transparency and credibility, mitigate moral hazard, and reduce uncertainty and confusion. It is also consistent with the CBA's previous recommendation that provincial policy, supervisory and regulatory frameworks be aligned with those of federally regulated financial institutions (including federal credit unions). In reducing deposit guarantee levels, British Columbians can be assured by the Auditor General's observation that an effective deposit insurance guarantee can still be

[14] Crisis Management and Bank Resolution Framework – Technical Note, Financial Sector Assessment Program for Canada, IMF Country Report no. 14/67, March 2014.
[15] Ibid.
[16] Financial Sector Stability Assessment for Canada, International Monetary Fund (IMF), IMF Country Report No. 14/29, February 2014.

achieved by covering most, but not all depositors and a significant value of deposits should not be fully covered[17].

Recommendation: Deposit insurance coverage for credit unions should be limited and harmonized with that of the CDIC.

Federal Credit Union Regime

Another acknowledgement of the growing size and complexity of credit unions is the federal credit union regime, which was created at the request of credit unions and established in 2012. The CBA strongly supported the development of the federal credit union regime and continues to do so.

The regime enables growth, consumer choice and seamless expansion of the Canadian credit union system across provincial boundaries within an appropriate prudential framework that protects the safety and soundness of Canada's financial system whilst recognizing the unique cooperative elements of credit unions. In order to support credit unions' transition to the federal credit union regime, the federal government last year committed to provide temporary transitional support to eligible credit unions that have provincial government acceptance to move to federal regulation.

The CBA believes that the federal credit union regime is a much more preferable option than the "home and host principal regulator" approach allowed under the B.C. FIA. To date, British Columbia is the only province that has implemented such a legislative framework, while two other provinces still require regulations. Credit unions utilizing this approach would subject their business strategies to the legislative and regulatory priorities and schedules of other provinces. In contrast, credit unions considering chartering under the federal credit union framework would benefit from the streamlined regime already in place and applicable across the country.

The federal credit union regime would best address many of the issues raised in the Consultation Paper and the Auditor General's report regarding credit unions, particularly those that are large and systemically important. As credit unions continue to consolidate, the ability to grow and expand across provincial borders through a federal framework would provide a safer means by which they could achieve economies of scale and scope, as well as benefit from greater risk diversification. Credit unions would benefit from the same prudential policy, supervisory and regulatory regime as banks, strengthening B.C.'s financial system.

Recommendation: Credit unions, particularly those that are large and systemically important, should be encouraged to transition to the federal credit union regime.

[17] Jones, Russ. Office of the Auditor General of British Columbia, Credit Union Supervision in Canada, March 2014.

Insurance Sector

Insurance Retailing and Licensing Exemptions

Banks in Canada are committed to providing their customers' with financial products and services that best suit their customers' needs. Many of these customers depend on the financial assistance that bank-offered insurance products such as credit insurance, creditors' disability insurance, and creditor's loss of employment insurance, provide. These types of insurance products help ensure that customers continue to meet their financial obligations during times of crisis and allow customers to more easily focus on themselves and their families.

The assumption in the Consultation Paper that exempted sellers will act in a good faith manner with regard to these types of insurance to maintain the business relationship with the consumer certainly holds true when the seller is a bank. Banks generally have long standing relationships with their customers across a broad range of products (credit cards, mortgages, deposit accounts, etc.). Maintaining long-term, favourable relationships with customers is thus extremely important to banks and insurance is not sold by banks in the context of a one-time transaction relationship.

The CBA continues to believe that the federal regulatory regime that applies to authorized insurance products offered by banks is robust and provides all of the consumer protections that are needed. For example, under the *Bank Act* banks are prohibited from coercive tied selling, while under the *Cost of Borrowing Regulations* (*Banks)* banks are required to disclose pertinent details relating to credit insurance, and consumers are afforded cancellation, and refund rights[18]. In addition, banks in Canada have committed to the *CBA Code of Conduct for Authorized Insurance Activities* that, among other requirements, establishes training and complaint procedures[19]. The banks' federal consumer regulator, the Financial Consumer Agency of Canada (FCAC), oversees the banks' compliance with these obligations.

In summary, there are strong policy reasons for continuing to exempt banks from the requirement to hold an insurance agent license while acting in connection with credit insurance. Duplicative regulatory regimes do not provide additional protection to consumers and may create unnecessary burdens that may impact the banks' ability to effectively offer these important insurance products to their customers.

Recommendation: The CBA strongly supports maintaining the existing exemption for banks in the British Columbia *Insurance Licensing Exemptions Regulation*.

[18] See section 16 of the *Cost of Borrowing Regulations (Banks)* for more information.
[19] "*CBA Code of Conduct for Authorized Insurance Activities*" ,CBA Website, http://www.cba.ca/contents/files/misc/vol_20090000_authorizedinsuranceactivities_en.pdf.

Trust Sector

Regulatory Framework for Trust Companies and Regulation of Trust Business

The changes to the legal framework and marketplace beginning in the 1980s that resulted in more integration in the financial sector have benefited consumers. In particular, allowing financial institutions to offer more products and services than were traditionally permitted has enabled them to organize themselves in the most cost effective way to deliver these products and services.

Further changes are needed in this area. In particular, "core" fiduciary activities are still limited to trust companies. While the CBA continues to believe that banks should be permitted to participate in such trust activities directly, this is not currently permitted. As a result, federally regulated banks carry out these activities through their federally incorporated trust and loan company subsidiaries.

It is important to note that the federal *Trust and Loan Companies Act* (Act) already establishes obligations in connection with fiduciary duties applicable to such companies. In particular, section 422(1) of the Act provides that a trust and loan company must keep money and other assets acquired or held in trust by the company *"separate and distinct from its own assets"* and must *"keep a separate account for each trust"*. Compliance with this obligation, along with others, is overseen by OSFI. Further fiduciary obligations have also been established and refined by the courts over many years through carefully considered, and fact specific, case law. Enforcement of the law relating to trusts and fiduciary duties is therefore rightly the primary responsibility of the courts, not the British Columbia Ministry of Finance by way of the British Columbia *Financial Institutions Act*.

As the Consultation Paper points out, the British Columbia government has received very few complaints about trust companies and most of the deposit-taking trust companies in British Columbia are federally incorporated. Concerns with potential conflicts of interest between federally regulated financial institutions and their federally incorporated trust companies would therefore appear to be misplaced.

It is our understanding that only one concern in particular was raised about a potential conflict of interest in respect of the amount of interest paid in connection with un-invested cash balances in registered accounts (e.g., RRSPs) held at bank-owned trust company subsidiaries. In response to this concern, we would like to draw your attention to the following points:

- un-invested cash balances held in registered accounts are not meant to be long-term, interest bearing accounts, but rather short-term, temporary accounts that generally hold small amounts of cash to be re-invested;
- engaging an agent other than a bank-owned subsidiary to set the interest rate to be paid would result in less efficiency and increased costs and would not be in the best interest of consumers (especially when the attributes of the un-invested cash balances are taken into account); and,

- consumers remain free to move such balances to other, higher interest bearing accounts if they wish.

Recommendation: In light of the foregoing, the CBA strongly believes that federally incorporated trust companies and the banks that own them should only be subject to federal legislation and regulation, and recommends that any twofold oversight structures be removed. In addition, individuals that carry on trust businesses that are not regulated, or that work for corporate entities that are not regulated, should be regulated, as should non-regulated associations. Regulation is required in these cases to ensure consumers are protected and to mitigate the risks associated with carrying on this type of business.

Financial Literacy

Banks and other financial institutions in Canada have a role to play in helping to strengthen financial literacy. The CBA and its members are helping British Columbians improve their financial literacy in a number of ways, including working with targeted groups such as students and seniors, assisting customers and community initiatives and contributing to government initiatives to develop and implement a financial literacy strategy.

The CBA has provided financial literacy programs to young people for over 15 years through its Your Money Students seminars. In British Columbia, local bankers have volunteered to deliver close to 1,200 free seminars to 36,000 young people in the classroom over that time, teaching them the basics of budgeting, saving, investing, using credit wisely and fraud prevention.

The CBA also recently launched a financial literacy program for seniors, Your Money Seniors, to assist retirees and those who are entering retirement in managing their finances and avoiding financial abuse and fraud.

Banks in Canada are an active and essential part of the daily life of most Canadians – 96 per cent of Canadians have an account with a financial institution, and millions turn to banks every day for services and advice to help them save, plan for retirement, start businesses and buy homes. As a result, banks already provide their customers and potential customers with a wealth of educational material, information, tools and services geared to helping them make the best financial choices.

Banks are also leaders in supporting financial literacy activities and initiatives in communities across Canada. There are many community organizations delivering financial literacy to vulnerable groups across Canada and many of these programs are supported by banks and individual bankers.

The banking industry also contributed to the federal government's Task Force on Financial Literacy, and strongly supported many of the recommendations it delivered. As a result of the Task Force, the federal government appointed its first Financial Literacy Leader and participated in multiple consultations to develop the National Strategy for Financial Literacy – Count Me In. The CBA sits on the National Steering Committee that has been charged with implementing the National Strategy. The National Strategy identifies three goals that will help Canadians strengthen their financial literacy: managing money and debt wisely, planning and saving for the future; and preventing and protecting against fraud and financial abuse.

Recommendation: The CBA recommends that British Columbia continue to raise awareness of, and promote, existing programs and services that seek to strengthen the financial literacy of British Columbians consistent with the goals of the National Strategy for Financial Literacy – Count Me In.

Reporting Financial Abuse

The banking industry has long been a leader in assisting in the reporting of financial abuse, particularly with seniors. The industry has advocated for changes to legislation that would enable them to help prevent this financial abuse. This experience can help guide the provincial government in drafting proposals for financial institutions under its jurisdiction.

Before the federal *Personal Information Protection and Electronic Documents Act* (PIPEDA) came into force, bankers had a common law right (*Tournier* decision) that allowed disclosure without consent when it was in the public interest. This was generally used by the banks to address situations such as when a customer, particularly a senior, is withdrawing money under duress. Following the coming into force of PIPEDA, the banking industry still felt a moral obligation to help their customers avoid financial abuse, and families and seniors' advocates still expected banks to take action, but PIPEDA limited banks' ability to assist their customers to instances related to a contravention of a law.

In 2006, when the five-year review of PIPEDA began, the banking industry advocated for provisions in the law that would allow organizations to disclose the personal information of their customers without their consent for the purpose of preventing suspected financial abuse. On June 18, 2015, the *Digital Privacy Act* received Royal Assent enabling banks and other organizations to disclose personal information without the knowledge and consent of an individual only to governments, the individual's next of kin or authorized representative. This may only be done if there are reasonable grounds to believe that the individual has been, is or may be the victim of financial abuse and solely for purposes related to preventing or investigating the abuse.

The banks are currently working to develop and implement the procedures and training that will allow bank staff to utilize this provision to assist their customers. Key considerations include: a) wherever possible and appropriate, speaking first to the customer about their wishes; b) making all reasonable efforts to ensure that, when reaching out to next of kin or other authorized representatives, the bank does not tip off the abuser; and, c) releasing only the minimal amount of personal information about the customer needed to prompt action by the receiving party.

Recommendations: We believe that provincially-regulated financial institutions would similarly find it valuable to have the ability to disclose personal information to help their customers avoid financial abuse, and recommend that the British Columbia government

consider including in its legislation provisions allowing financial institutions to disclose potential financial abuse to family members or other authorized representatives that the financial institution reasonably believes are not involved in the suspected abuse.

Conclusion

The financial sector is undergoing a tremendous amount of change as a result of competition, technology and the global financial crisis. As the financial sector changes, it is important that all financial institutions operate within a robust prudential policy, supervisory and regulatory framework. This type of regulatory oversight - which includes an appropriate deposit insurance guarantee system, is essential, especially for credit unions that are growing to become large, complex, and in some cases, systemically important financial institutions. As both the financial sector and regulatory frameworks evolves with these changes, it is also important to avoid unnecessary overlap between provincial and federal regulatory financial frameworks while ensuring the continued safety and soundness of Canada's financial system as a whole.