



September 14, 2021

FSRA Policy Division
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Delivered by e-mail

Dear FSRA Policy Team,

RE: Response to FSRA’s Proposed Rule 2021 - 01 Sound Business and Financial Practices

Thank you for the opportunity to provide our thoughts on the Proposed Sound Business and Financial Practices Rule (“Draft Rule” or “Rule”). We sincerely appreciated FSRA’s time and interest in Alterna’s views during our recent meeting of August 26th. As promised, what follows is our written comments which we kindly ask you consider as you work towards the final draft of the Rule.

We support FSRA’s journey towards principles-based regulation, and we feel we are uniquely positioned to provide comments on the Draft Rule given our subsidiary bank is regulated under a principles-based regime. Our feedback is categorized into three main themes, being: (1) governance of federally-regulated subsidiaries, (2) separation of board and management roles, and (3) level of details within the Rule.

Governance of Federally-Regulated Subsidiaries

Expectations of credit union boards and management have been expanded throughout the Rule to oversee subsidiaries. Unfortunately, these requirements are problematic in Alterna’s case given that our wholly-owned subsidiary is a federally-regulated bank which is subject to regulation from the Office of the Superintendent of Financial Institutions (OSFI) as well as the Financial Consumer Agency of Canada (FCAC).

Specific to boards, the Rule requires that the board oversee and approve a number of key elements for its subsidiaries, including plans, policies, strategic initiatives, market code, mandates/budgets of oversight functions, risk management and resourcing. However, under the OSFI Corporate Governance Guideline the bank’s board of directors is also required to oversee and/or approve similar elements. The Rule’s subsidiary oversight provisions would result in a second level of review and approval. As a result, key documents could not be finalized and implemented until they are endorsed by parent’s board. Not only is this duplication clearly not practical, but we also believe that OSFI would object, as they hold the bank’s board accountable for the bank’s governance. We understand from our discussions

with the FSRA team that this is not the intent, but given the enforceability of the Rule, this would in fact be a requirement.

The Rule goes further by requiring the heads of the credit union's oversight functions to oversee risk, compliance, finance and internal audit for subsidiaries, and to report to the credit union board any material risks. In addition, as mentioned above the Rule requires that the credit union board approve the mandates for the subsidiary's oversight functions. This is an area of concern to Alterna Savings for several reasons:

- Alterna Bank is prohibited by OSFI from sharing certain regulatory documents with its parent and the parent's regulator. Confidentiality restrictions are provided in the *Supervisory Information (Banks) Regulation*, however there is no provision that allows disclosure to the parent's regulator. Given the confidentiality provisions of this Regulation, to include any bank supervisory-related information in the credit union board packages would risk Alterna Bank being in breach because these materials are shared with FSRA in normal course. In the past, FSRA has requested information such as the Bank's ICAAP but we were informed by OSFI that this is not permitted. We understand that further discussions between FSRA and OSFI have led to the same outcome.
- OSFI guidance sets the expectations for a bank's board of directors' relationship with heads of oversight functions. The additional level of governance and approval by the credit union board will call into question the independence of the Bank's oversight functions to which OSFI would object.
- Lastly, regulations and requirements from federal regulatory bodies can differ from those issued by FSRA which will create conflict and confusion for the oversight functions, the board and the regulators. A recent example is the variations between the federal Consumer Protection Framework and the proposed Credit Union Market Conduct Framework.

Consequentially, we would not be able to comply with the new Rule as currently drafted in relation to subsidiary oversight.

Understanding FSRA's intent is for the credit union board to oversee the strategy of subsidiaries as part of the consolidated entity, and to understand the material risks that may exist within subsidiaries. We suggest that a conversation between FSRA and OSFI would be helpful prior to finalizing the Rule. We also suggest the following:

1. Remove the word "subsidiaries" from Section 5 of the Rule (Responsibilities of the Board of the Credit Union), and in particular (but not limited to) paragraphs 5(3) and 5(4). A consequential amendment would also be required under paragraph 15 (1) (Operational Management).
2. Clarify throughout the Rule that governance of oversight functions by the credit union board does not apply to federally-regulated subsidiaries.

3. In keeping with principles-based regulation, allow credit unions to establish by policy how the credit union board will govern its subsidiaries, as contemplated in section 16(1) (Subsidiary Governance). For example, this policy could require the subsidiary board to report to the parent on the subsidiary's activities, and any material risk or compliance matter impacting the consolidating entity. Such disclosure or report would need to be made in a manner that does not breach confidentiality restrictions imposed under the federal regime.

Separation of Board and Management Roles

While paragraph 5 (2) of the Draft Rule states that the board and the credit union must maintain a clear division between the roles and responsibilities of the board and those of senior management, there are multiple other sections where there is either confusion between these roles, or where the board would clearly overstep into operational matters. In our recent meeting, FSRA emphasized that this was not the intent and we were very pleased to hear that. But because of the enforceability of the Rule it is important to all stakeholders that the requirements be clear, and flexible where they need to be. As requested, we are outlining our concerns on this matter below.

Section 5 of the Rule requires that the credit union board oversee and approve operational elements such as the following:

- Provide oversight of the decisions made by management.
- Oversee and approve processes and procedures.
- Appoint every member of senior management, and set their performance objectives.
- Approve the delegations of authority by the credit union's senior management.

Similar language requiring board approval of processes and procedures also appears in several other sections.

Section 9 also requires that the board develop, update and implement remuneration programs for senior management, as well as approve remuneration programs, policies and practices for all other employees. These activities (develop, update, implement) are typically undertaken by Management. The approval of remuneration practices for the general employee population also encroaches into the role of Management.

We are concerned that the language used in the Rule would have the unintended consequence to require the board to approve every decision, process, procedure and practice of the credit union. This would not be effective use of the board's time and take focus away from their governance responsibilities and strategic oversight. Board meetings would be excessively long, and potentially more frequent which unnecessarily consumes management time which would be best utilized on the strategy implementation and business operations. As written, the requirements of the Draft Rule would also cause the board to usurp the powers of the CEO,

making the role much less attractive and less effective. Over the longer term this would impact the credit union system performance.

We note that OSFI's Corporate Governance Guideline only requires the boards to approve the "significant policies, plans and strategic initiatives, that are related to, or that materially impact capital and liquidity". And while the OSFI Guideline does require the board to "challenge, advice and guidance" to senior management on certain operational policies and frameworks, there is no requirement to approve procedures, processes and practices. We suggest that FSRA consider using similar language to that used by OSFI, which provides more flexibility and better delineation between board and management, and is better aligned with the principles-based intent of the Rule. We also suggest that references to procedures, processes and practices be removed throughout the rule.

Level of Details

Having experience with principles-based regulation, and understanding that the Rule will have force of law, we have noted several areas where details could be scaled down. In our discussions with the FSRA Policy Team, we understand that FSRA's intent was to strike the appropriate balance between principles-based language and clarity of expectations.

The unintended consequence of the current level of detail is that it will lead to one-size-fits-all requirements, applicable to all credit unions regardless of their size and complexity, and without consideration for the governance structures and strengths of board and management. This will result in non-value added activities being performed by credit unions where they are in fact intended to apply on a case-by-case basis.

To avoid codifying requirements and details where flexibility of interpretation and application are intended, we suggest that the Rule be simplified. Below is a non-exhaustive list of examples:

- Sections 6 and 15 – There is duplication in these sections regarding the role of senior management.
- Par 8(2) - Provides a requirement to disclose the viability and prospects of the credit union to its members. This requirement is ambiguous. As the paragraph already requires transparent disclosure, these details may be best left out of the Rule.
- Par 9(3) – Provides a requirement of the credit union to disclose to its members its policies and procedures regarding remuneration. Disclosure of procedures is too granular for the intended purpose.
- Par 9(4) – Provides detailed requirements to align remuneration with risk types, risk outcomes and time horizon of risks. This section could be simplified to be easier to digest by the average credit union.

- Par 10(7), 10(8) and 10(9) – Provide an exhaustive list of items to which the heads of oversight functions must have access at all times, their rights to participate in all meetings, and details of how they should go about their work. Some of these details are not required in all situations and we suggest these paragraphs be removed. Par 10(3) already requires policies be in place to govern oversight functions and each credit union could instead determine the scope of their own requirements within those policies.
- Par 14(2) - The head of the finance function shall: (i) advise the Chief Executive Officer and board of the credit union, including in relation to the matters described in subsection 14(1). This implies that the CFO is mandated to provide advice on matters unrelated to the finance function which is an unusual requirement.
- Par 15(2) – Provides an exhaustive list of management duties (beyond those of senior management) that would normally be addressed in policy and job descriptions.

Conclusion

We trust that our comments are constructive and helpful. Thank you once again for the opportunity to share our thoughts, and for the constructive dialog on this matter. Please feel free to reach out to us if you would like to discuss our recommendations in greater detail.

Best Regards,



Rob Paterson, President & CEO

