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Daniel Padro
Director - Policy (credit unions)
Financial Services Regulatory Authority

Dear Mr. Padro,

The Canadian Credit Union Association (CCUA) is the trade association for Ontario's credit unions and caisses populaires. We offer the following feedback to the proposed Rule 2021 – 001 "Standards of Sound Business and Financial Practices" (the "Rule").

Overall, we are pleased that the proposed Rule adheres to the current spirit of principles-based regulations, which should decrease FSRA's reliance on inherited prescriptive legal requirements. The exception being the area of compliance, where the general evolution of risk management has resulted in more detailed and extensive guidance.

Nonetheless, despite the stated goal of drafting a principles-based, outcome-focused Rule that is short and concise to replace DICO's By-law 5, we suggest there are areas in which the language of the Rule has inadvertently become overly prescriptive in the absence of more context and explanation.

It is our understanding that FSRA is already planning amendments to the Rule to increase the clarity of certain sections and we support the development of such amendments. It is our expectation that these amendments be announced well in advance of the release of the final Rule, whether via the Stakeholder Advisory Committee or equivalent route.

In the meantime, we appreciate the opportunity to provide the following feedback to the Rule. Our response is divided into two parts: first, we make comments on the Rule as a whole; and second, we make specific recommendations for changes.

Proportionality vs. appropriate/prudent:

We expect the dual concepts of 'appropriate/prudent' and 'proportionality' will be the foundation of FSRA's Risk Based Supervisory Framework and that this framework will come into effect alongside the Standards of Sound Business and Financial Practices Rule. While similar, the two concepts have different meanings.

The concept of *appropriate* and *prudent* is the foundation of a principles-based regulatory regime. Firms are given considerable flexibility to design and implement policies and procedures that work best for their membership and corporate culture and then demonstrate to the regulator(s) that their policies and procedures are appropriate and sufficiently prudent to achieve said objectives.

The concept of *proportionality* deals with the measure of regulatory intensity, not a means for credit unions to determine the appropriateness of a policy or procedure, and the onus is on the regulator to demonstrate that its interventions are proportional to the risk that is being addressed.

Role vs. Individual:

As one individual may have multiple roles within the credit union, the use of the word "role" would be preferable to "individual". In such cases, it is for the credit union to demonstrate how the oversight individual is fulfilling the responsibilities of their role and for FSRA to allow proportionality to guide expectations.

Senior Management vs. CEO:

Many sections of the Rule state that the Board of Directors "shall oversee and approve" matters relating to both "the chief executive officer and other members of its senior management including the heads of the oversight functions." This seems contrary to the basic governance concept that a Board of Directors is responsible for oversight and planning, but has limited involvement in everyday operations, which are the responsibility of senior management.

We recommend these sections be amended to clarify that the primary reporting relationship of senior management, including risk management, is to the CEO, with access to the Board of Directors for oversight functions. For greater clarity, we recommend that it be made clear that that the CEO is responsible for hiring and managing all employees, including the heads of the oversight functions, subject to Board oversight and access.

Board oversight of Processes and Procedures

Similarly, we recommend that a clearer distinction be made between the role of the Board of Directors and the role of Senior Management with regards to oversight of "policies" "processes" and "procedures". While it is a Board of Director responsibility to oversee corporate "policies", the CEO and Senior Management are responsible for approving "processes" and "procedures" aside from material decisions made outside of the normal course of a credit union's operations.

Subsidiaries:

The oversight responsibilities of the parent company Board of Directors of a regulated subsidiary should be different than those of an unregulated subsidiary. We recommend FSRA distinguish Board oversight responsibilities of the parent company from Board oversight of a subsidiary and that, for regulated subsidiaries, the parent Board's responsibilities should be more narrowly limited to understanding the regulatory environment the subsidiary operates in and the risk the subsidiary could pose to the parent company.

Other comments

Section 1 (5) For the purposes of this Rule,

(i) whether an individual or entity is independent is exclusively a question of fact,

(ii) an independent individual is free from influences that compromise judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism, and

(iii) an individual is independent of a credit union if the individual, or a related person of the individual, does not have a direct or indirect material or pecuniary relationship with a credit union, including a subsidiary, other than ordinary remuneration provided to an individual who is a director of the credit union or a subsidiary or as a member of the credit union, and has not been an officer of the credit union for at least twelve months.

We recommend that Section 1(5) be simplified by removing (iii). An independent individual is one with no conflicts of interest which is well defined in (ii).

Section 4(1)

Subject to subsection 4(6), a credit union shall have a board with an appropriate size and structure, composed of directors who have appropriate skills, education, experience and commitment to enable them to discharge their duties and responsibilities effectively, having regard to the nature, size, complexity, operations and risk profile of the credit union.

All credit union's look to assemble a Board with a diversity of skills, education, experience but supervisors' must be willing to appreciate that an election may not result in the person FSRA believes has the most appropriate skills being elected.

Section 4(2)

The board or senior management of the credit union, as applicable, shall only,
(i) appoint an individual or individuals to become a director or directors of the board of the credit union, or

We don't believe it is appropriate for senior management to appoint an individual to the Board of the credit union as it conflicts with the principle of democratic member control. Senior management may recommend an individual to the membership but ultimately that individual must be approved by either the membership or the Board. In the same vein – we don't consider it appropriate for the Board or the Senior Management to block the election of an individual to the Board without cause.

Section 5(3) (i)

The board of the credit union is responsible for providing oversight, supervision and direction to management, and shall oversee and approve:
*(i) the credit union's and **its subsidiaries':***
*(a) **short-term and long-term business plan and strategy**,*
*(b) **material decisions made outside of the normal course of the credit union's operations**,*
*(c) **significant strategic initiatives,***
(d) policies, processes and procedures as required by the Act, its regulations and rules,
(e) code of market conduct,
(f) plans related to capital and liquidity management,
(g) mandates and budgets for the oversight functions, and
(h) risk management

As noted earlier – we recommend that subsidiary oversight be split from oversight of the parent company as a Board responsibility, especially in cases where the subsidiary has a stand-alone board and a different primary regulator.

Section 5(3)ii and Section 9(1):
*The board of the credit union… shall oversee and approve…the appointment, setting of performance objectives, compensation, incentives, succession plans and reviews of the credit union's chief executive officer **and other members of its senior management including the heads of the oversight functions**, in accordance with subsection 9(1) of this Rule,..*

*The board of the credit union shall **create, develop, update** and implement remuneration programs, policies and practices for the members of the board, including board committees, and **senior management of the credit union**, and which is structured appropriately to attract, retain and motivate high-quality directors and **members of senior management**, proportionate to the credit union's nature, size, complexity, operations and risk profile.*

As worded, this would make the board potentially operationally responsible for hiring, compensation practices and negotiations, and performance reviews of all senior management positions, bypassing the CEO and other senior management reports. It is a Board's oversight responsibility to approve policies and ensure that HR practices are *structured appropriately to attract, retain, and motivate high-quality … members of senior management* (section 9(1)). This is accomplished by board review and approval of policies, reporting to the board, board evaluation of outcomes, and appropriate direct access by board to senior functions (finance, compliance and risk).

6 (1) (ii) (b) identify an ethical framework for the credit union's operational management, and

We understand that FSRA's intention with this section of the Rule is that credit unions must have a code of market conduct. We support this approach.

Section 9(4) i through v:

The credit union shall ensure that its remuneration programs, policies and practices referred to in subsections 9(1) and 9(2) of this Rule, are consistent with the following:

(i) employees engaged in the oversight functions are renumerated in a manner that is independent of the business areas they oversee and commensurate with their key role in the credit union,

Oversight/compliance cannot be separate independent departments, and thus there is likely a degree of overlap with operations. As noted above, the wording should allow for flexibility by referring to the "role" rather than to the "employee".

(ii) remuneration is adjusted for all types of risk,
(iii) remuneration is symmetric with risk outcomes,
(iv) remuneration payout schedules are sensitive to the time horizon of risks, and
(v) forms of remuneration are be consistent with risk alignment.

ii, iii, and v . in conjunction with other sections on remuneration are unnecessarily prescriptive. It would be difficult for small to mid-size credit unions to specify "all types of risk" and symmetry in its remuneration practices for individual roles This section could be simplified by removing (ii) through (v) and replacing with "renumeration practices are commensurate with long-term outcomes rather than short term gains". This would also be easier for a Board of Director to oversee.

Section 10(2) and 10(7):

The head(s) of the oversight functions…

It is acknowledged in these sections that the oversight function including the "head" of the oversight function may be outsourced. However, at all times *a member of the Credit Union's senior management remains accountable for the performance of such individual and oversight functions…* The rule is best clarified by discussing the independence, responsibilities and reporting requirements of the "function" as opposed to the "head", as the day-to-day head of the function and resource for staff is the credit union accountable appointee, and not the outsourced resource that is typically engaged in an advisory, consulting, data processing, or auditory role and not an operationally available resource and report for staff.

The heads of the oversight functions… shall at all times have direct and unrestricted access to…. computer systems, including back-up systems.

This section and 10(7) should be qualified by “appropriate”. Unrestricted access to electronic systems is generally restricted to the domain administrator(s) and the appropriately qualified external information security auditors.

Sections 12(2) and 13(2)

The head of the [two] function[s] of the credit union shall be appointed by and report to the board of the credit union.

The wording (like with the Section 5(3)ii and Section 9(1) discussed above) suggests these “heads” are appointed, managed by, and reports directly to the board. We understand that FSRA will clarify these sections to the effect that only the CEO “reports” directly to the board. The compliance function heads should indeed have independent unfettered access to the board or board committees (and vice versa), and provide regular periodic reports to the board and committee.

In conclusion, while we are generally pleased by the spirit and intent of the Rule, we respectfully suggest that the amendments noted above would be beneficial. We look forward to continued discussion and continued work with FSRA on the renewal of the credit union and caisses populaires regulatory framework.

Sincerely,

Nick Best