

**A harbinger of regulation to come:
OSFI proposes further oversight over Canadian
financial institutions – are Branches next?**

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Background

Canada's regulator of financial institutions, the Office of the Superintendent of Financial Institutions ("OSFI"), recently updated its Corporate Governance Guideline ("CGG"), which applies to all financial institutions incorporated in Canada. Following up on this update, OSFI has released a draft advisory entitled "Changes to the Membership of the Board or Senior Management" (the "**Draft Advisory**"). The Draft Advisory, if adopted, would provide guidance to federally-regulated and -incorporated financial institutions ("**FRFIs**") that propose changes to their board or senior management ("**Company Leadership**").

While the CGG and the Draft Advisory are not applicable to the branch operations in Canada of foreign banks or foreign insurance companies ("**Branch Operations**"), the Draft Advisory is indicative of a regulatory trend in Canada. It also highlights the possibility that changes in respect of Chief Agents (insurers) and Principal Officers (banks) or senior management positions (collectively "**Branch Leadership**") of Branch Operations may be next on OSFI's agenda. Accordingly, Branch Operations should be aware of the obligations proposed in the Draft Advisory, which are applicable to incorporated FRFIs, because similar changes might be proposed for such Branch Operations.

Specifically, the Draft Advisory attempts to better-integrate OSFI's Guideline E-17 (Background Checks on Directors and Senior Management of FREs) ("**Guideline E-17**") with the CGG. Guideline E-17, which took effect in 2008 and applies to Branch Operations as well as FRFIs, is aimed at mitigating risks associated with the leadership of an organization. Specifically, among other things, Guideline E-17 requires that FRFIs and Branch Operations adopt and implement written policies aimed at assessing the suitability and integrity of "responsible persons", including Company Leadership and Branch Leadership. This would be achieved through certain regular background checks and assessments of proposed and existing members of Company Leadership and Branch Leadership, as discussed in greater detail below.

Proposed Changes in the Draft Advisory

The changes proposed within the Draft Advisory can be divided into two parts: (1) the requirements for early notification by an FRFI, including timing and form, of proposed changes to its Company Leadership; and (2) OSFI's right, in its discretion, to request an introductory meeting with newly-appointed or -elected members of Company Leadership. Please bear in mind that the proposed changes set out in the Draft Advisory, which are summarized below, apply only to Canadian-incorporated financial institutions, but should serve as a caution to foreign companies with Branch Operations in Canada.

Early Notification

The timing requirements for notification to OSFI of proposed changes to Company Leadership vary depending on the position. If a change is proposed to the membership of senior management, OSFI would require that notification be provided to OSFI a minimum of 30 days prior to the appointment taking effect. As set out in the CGG, the criteria of who qualifies as "senior management" will vary across institutions and the organizational structure of the entire FRFI would need to be reviewed to assess which positions would be included in this category. If a change is proposed to the membership of the board of

directors of an FRFI, OSFI would require that notification be provided “as soon as the preferred nominee for election or appointment is identified”.

The content for notification to OSFI of proposed changes to Company Leadership is also set out in the Draft Advisory. OSFI will expect to receive (1) the *curriculum vitae* of the candidate demonstrating the candidate’s suitability for the position; (2) the rationale for the candidate’s selection; and (3) the effective date of the proposed appointment. OSFI will also want a copy of the draft announcement of the proposed appointment and the results of the “Responsible Persons assessment” conducted by the FRFI in accordance with Guideline E-17 as part of the requirement to conduct certain background checks on candidates for Company Leadership positions.

The pre-appointment notifications described above would, if included in a final advisory, be in addition to existing statutory notice requirements, and not in place of these requirements.

If OSFI decides in the future to issue an advisory applicable to Branch Operations along the lines of the Draft Advisory, we expect that notification requirements will be similar: OSFI will require notice when a new Chief Agent or Principal Officer is identified, and at least 30 days prior to the appointment of membership of senior management.

Introductory Meetings

The Draft Advisory, as written, would permit OSFI to request an introductory meeting with the newly-appointed or -elected member of Company Leadership of “large, complex FRFIs” (which would include domestic systemically-important banks), the purpose of which would be to allow OSFI to meet and become acquainted with that new member, apprise the new member of his or her duties, discuss the points of interaction between OSFI and the FRFI and explain OSFI’s supervisory activity in relation to the applicable FRFI. Ostensibly, the meeting offers OSFI a chance to confirm the suitability of the new member of Company Leadership and potentially take follow-up action if the meeting is unsuccessful.

If OSFI decides in the future to issue an advisory affecting Branch Operations, it may provide for similar meetings with each new member of Branch Leadership, though it would be conjecture to project at this point which Branch Operations, if any, would qualify as “large, complex” institutions.

Implications of the Draft Advisory for Branch Operations

If OSFI in the future decides to issue an advisory or other guidance affecting Branch Operations which is similar to the Draft Advisory (a “**Branch Advisory**”), this Branch Advisory would integrate with OSFI Guideline E-4A (Role of the Chief Agent and Record Keeping Requirements), in relation to foreign insurers in Canada, and OSFI Guideline E-4B (Role of the Principal Officer and Record Keeping Requirements), in relation to foreign bank branches in Canada (collectively the “**Branch Guidance**”).

OSFI’s Powers

The Draft Advisory, if implemented, would provide OSFI with a great deal of oversight in the appointment by FRFIs of new members of Company Leadership. For example, the Draft Advisory provides that, “[t]o the extent that OSFI may have any specific concerns regarding the appropriateness of a candidate, OSFI will inform the Board of the FRFI...prior to the candidate’s appointment or nomination for election.” We

expect that if OSFI decided to issue a Branch Advisory, it would be based on the same principles as the Draft Advisory and would:

- 1) provide OSFI with the ability to restrict whom a Branch Operation appoints to Branch Leadership, including a *de facto* veto of new appointees;
- 2) require Branch Operations to provide OSFI with notice of proposed changes to Branch Leadership within the required timelines, together with the necessary background documentation. It would be important for Branch Operations to consider the most effective way to present the required documents. It remains important for Branch Operations to maintain comprehensive records of relevant materials obtained during the selection or hiring process, such as results of background checks performed in the context of Guideline E-17; and
- 3) give OSFI the ability in its discretion to require a meeting with any proposed new member of Branch Leadership, the purpose of which would be to not only give OSFI an opportunity to assess the new member, but also to emphasize the statutory obligations of Branch Operations and the obligations of the Branch Leadership, together with OSFI's expectations.

The future of Guideline E-17

The Draft Advisory's intersection with Guideline E-17 suggests that OSFI has determined that Guideline E-17 was insufficient or incomplete and is a chief reason why we expect that similar OSFI guidance will be introduced that will apply to Branch Operations. A future Branch Advisory if ever issued by OSFI may contain similar requirements to provide OSFI with evidence that the Branch Operation is complying with the background check requirements of Guideline E-17. This would bring branch administration of Guideline E-17 in-line with FRFI administration of Guideline E-17, as contemplated by the Draft Advisory.

If a Branch Advisory is brought into effect in a form similar to that of the Draft Advisory, Branch Operations would want to protect themselves if a proposed member of the Branch Leadership is unsatisfactory to OSFI. In addition to guarding against public relations concerns, Branch Operations would want to advise candidates of the process set out in a Branch Advisory and OSFI veto risks. In particular, the hiring of any candidate should continue to be conditional upon satisfactory initial and continued Guideline E-17 background checks and "for cause" grounds of termination should include expressed OSFI concerns in general and unsatisfactory Guideline E-17 background checks in particular. Branch Operations should continue to require, as a condition of employment or appointment, consent from the Chief Agent/Principal Officer or other member of Branch Leadership to conducting the appropriate and applicable background checks, together with regular attestations.

Additional Thoughts

While a Branch Advisory would provide some clarity as to the information that OSFI is seeking about proposed changes to Branch Leadership, and when it expects to receive these materials, the Branch Advisory may nevertheless leave some questions unanswered. For example, it may not be clear at what point OSFI will consider a Chief Agent or Principal Officer to have been "identified" for the purposes of notification to OSFI. This might occur upon initial meeting, at some subsequent point when the candidate is actually being considered for the position, or when the candidate agrees that his or her name may be

put forward. Our general view is that, absent OSFI guidance to the contrary in a Branch Advisory, a foreign company likely should consider a Chief Agent or Principal Officer to have been “identified” for this purpose once a decision has been made by the appropriate body of the foreign company, such as the board of directors or relevant committee of the board of directors, to formally approach the person with the offer of the position and having received acceptance from that person to serve in that position, subject to OSFI clearance and formal appointment.

The varying composition and titles and roles of senior management across organizations would also add complexity to the situation. While OSFI has rightly noted in the Draft Advisory that the composition of senior management of a Canadian FRFI will vary among institutions, there will be occasions when it will be unclear if a position qualifies as “senior management”. We expect that a similar advisory applicable to Branch Operations if ever issued by OSFI would raise similar questions. It is likely that, for the purposes of Branch Operations, “senior management” will include, at minimum, those persons considered “Responsible Persons” for the purposes of Guideline E-17, including the Chief Agent/Principal Officer.

Dentons Canada LLP provides this update to help branches in Canada of foreign insurance companies and banks become aware of regulatory trends in Canada, together with regulation and guidance that may reasonably be seen as upcoming. Dentons Canada LLP will continue to monitor the progress of the Draft Advisory and other OSFI guidance and will provide updates when available.

For more information about the Draft Advisory or other OSFI Guidance, please contact [Hartley Lefton](#) (+1 416 863 4353 or hartley.lefton@dentons.com).

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