



Guideline Impact Analysis Statement

Guideline E-17

Assessments of Responsible Persons by FREs

I. Background

The suitability and integrity of individuals who are responsible for the management of federally regulated entities (FREs) are important prudential concerns, as institutional stability, financial soundness and reputation can be negatively affected by the actions of those individuals.

Currently, OSFI assesses the suitability and integrity of directors and senior officers of FREs upon authorization¹. OSFI performs background checks for criminal records and investigations and uses curriculum vitae provided by applicants to evaluate whether their skills and experience are commensurate with the proposed position of the individual within the FRE. Post authorization, OSFI relies on the FREs' own internal processes and, where warranted, applies a risk-based approach to assessing the FREs' processes.

II. Problem Identification

The Core Principles for Effective Banking Supervision Methodology, issued by the Basel Committee on Banking Supervision in October 2006, indicate that banking supervisors should, as part of their licensing process, evaluate directors and senior managers of banks as to expertise and integrity. Further, the criteria for issuing licences are consistent with those applied in ongoing supervision.² The Insurance Core Principles, issued by the International Association of Insurance Supervisors in October 2003, state that the significant owners, board members, senior management, auditors and actuaries of an insurer should possess the appropriate integrity, competency, experience and qualifications³. Finally, Recommendation 23 of the Financial Action Task Force Recommendations on Money Laundering⁴ states that authorities should take necessary measures to prevent criminals or their associates from holding a significant controlling interest or holding a management function in a financial institution. These core principles provide an internationally accepted benchmark of minimum supervisory standards against which the quality of a country's prudential supervision system will be measured and assessed.

¹ The assessment criteria examined by OSFI upon authorization are found at sections 27, 526 and 675 of the *Bank Act*, section 27 and 712 of the *Insurance Companies Act*, section 26 of the *Trust and Loan Companies Act*, and section 27 of the *Cooperative Credit Associations Act*.

² October 2006, Basel Core Principles Methodology, Principle 3, Essential Criteria 3 and 8, available at <http://www.bis.org/publ/bcbs130.pdf>

³ October 2003, IAIS Core Principles and Methodology, Principle 7, Essential Criteria d, available at <http://www.iaisweb.org/358coreprinciplesmethodologyoct03revised.pdf>.

⁴ June 2006, Financial Action Task Force, Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations, Recommendations 23, Essential Criteria 23.3, available at <http://www.fatf-gafi.org/dataoecd/45/15/34864111.pdf>



It is important that OSFI and FREs meet minimum international standards and that OSFI aligns its practices with those of comparable supervisory regimes, in order to contribute to the long term stability and competitiveness of the federally regulated financial services industry.

Currently, OSFI verifies that directors and senior officers of FREs, including principal officers of foreign bank branches and chief agents of insurance company branches (collectively, Responsible Persons) meet minimum standards of suitability and integrity when the FRE is established in Canada and follows up as warranted on an ongoing basis using a risk-based approach.

OSFI recognizes that FREs already have various policies and procedures in place to regularly assess the suitability and integrity of their Responsible Persons to satisfy their own internal requirements (e.g., hiring policies or code of conduct) or to satisfy other regulatory requirements (e.g., public listing requirements). OSFI expects that such policies and procedures differ among FREs in order to reflect the particular circumstances of each FRE. OSFI seeks to clarify expectations with regard to fundamental aspects of such policies and procedures across institutions to minimize safety and soundness concerns, including prudential and reputation risk.

III. Objectives

Based on the foregoing, OSFI seeks to:

1. Reduce FREs' exposure to reputation and other prudential risks that could result from mismanagement or misconduct by identifying minimum expectations regarding the assessment of the suitability and integrity of Responsible Persons;
2. Align OSFI's practices with those of comparable supervisory regimes; and
3. Ensure that OSFI meets minimum international standards.

IV. Options and Assessment

Option 1 - Status Quo

In the short term, this option would not present incremental costs to either OSFI or FREs, and could be seen as minimizing the regulatory burden, but would not address the objectives listed above. This approach would also lead to a continuation of inconsistent assessments of Responsible Persons across FREs. This poses a potential risk to FREs, depositors and policyholders. Under this option there would be no additional benefits to FREs, depositors, policyholders or OSFI.

Option 2 - FREs to Assess Suitability and Integrity of Responsible Persons against Guidance issued by OSFI

Pursuant to this option, OSFI would issue guidance expecting FREs to develop policies and procedures to perform assessments of the suitability and integrity of their Responsible Persons. As such, FREs would be responsible for ensuring that their Responsible Persons meet minimum standards of suitability and integrity. OSFI would only become involved when it has material concerns about a Responsible Person. This framework is supported by a legislative provision enabling OSFI to remove directors and certain senior officers who do not meet the minimum standards of suitability and integrity. While policies elaborated by FREs should not permit a person who does not meet minimum standards of suitability and integrity to be a Responsible Person, OSFI

and FREs may from time to time disagree about the risk posed by a particular individual and the FRE will not or cannot take action to overcome the problem. In the most serious circumstances, OSFI may exercise its removal powers or take other remedial actions as appropriate.

This approach would ensure that all FREs benefit from clear expectations and are informed about minimum assessment parameters, and would reduce the FREs' exposure to reputation risks and other prudential risks that could result from mismanagement or misconduct. Moreover, this approach would result in OSFI and FREs being generally compliant with minimum international standards.

OSFI would incur costs in developing guidance, including conducting consultations and effecting implementation. This option will benefit the interests of depositors and policyholders because it reduces the FREs' exposure to reputation and prudential risks.

Option 3 - OSFI to Assess whether Responsible Persons meet Minimum Standards of Suitability and Integrity

This approach involves OSFI identifying standards it would use to assess Responsible Persons of financial institutions on an ongoing basis. Under this approach, FREs would provide information to OSFI, who would then determine whether Responsible Persons meet minimum standards of suitability and integrity.

This option would benefit the interests of depositors and policyholders because it reduces the FREs' exposure to operational and reputation risks. However, this option would require additional OSFI resources because of the time required to conduct ongoing assessments. This approach deviates from OSFI's overall reliance based regime, as less reliance would be placed on the management and board of the FREs for ensuring compliance with applicable legislation and guidelines. Also, the introduction of mandatory supervisory procedures would deviate from OSFI's risk based supervisory approach. Supervisory resources would need to be increased. This option would result in additional costs to OSFI that would be passed on to the FREs.

V. Consultations

OSFI consulted internally and with a number of FREs to confirm the extent of current practices. OSFI also contacted a number of international prudential regulators to gain an understanding of international approaches. OSFI will also conduct external consultations by posting the draft Guideline for comment on its external website.

VI. Recommendations

Option 2 addresses all objectives outlined above and provides the most effective means of safeguarding depositor and policyholder interests by guiding FREs in the development policies and procedures for the assessment of Responsible Persons. This option would be less resource intensive than Option 3 and would be more aligned with OSFI's framework of risk-based supervision and reliance based regulation.

VII. Implementation & Evaluation

OSFI will review comments received on the draft Guideline and will revise the Guideline as appropriate.

To assess whether the minimum requirements of the Guideline have been achieved, OSFI will undertake a targeted one-time post-implementation review of FREs' policies and procedures for assessing the suitability and integrity of their Responsible Persons.