

OSFI Issues Final Corporate Governance Guideline

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The Office of the Superintendent of Financial Institutions (OSFI) recently published the final revised version of its Corporate Governance Guideline (dated September 2018) (the Revised Guideline).

Background

The original Corporate Governance Guideline, which was first issued in 2003 and later revised in 2013, was designed to set out OSFI's expectations for boards of directors of federally regulated financial institutions (excluding branch operations of foreign banks and foreign insurance companies). The Revised Guideline is intended to consolidate all of OSFI's expectations for boards of directors.

The Revised Guideline continues to complement:

- relevant provisions of the *Bank Act*, the *Insurance Companies Act*, the *Trust and Loan Companies Act*, the *Cooperative Credit Associations Act* and associated regulations; and
- OSFI's Supervisory Framework and Assessment Criteria.

September 2018 Revisions

The Revised Guideline is intended to be more principles-based and to place greater focus on the effectiveness of boards of directors, by providing boards with clear principles that replace expectations listed in all risk management and capital guidelines and advisories. Consequently, boards of directors of federally regulated financial institutions are provided with increased discretion with respect to satisfying OSFI's corporate governance expectations.

Some of the material revisions include the following:

- Boards of directors of federally regulated financial institutions are now given increased discretion with respect to their meeting the principles underlying the Corporate Governance Guideline by allowing such directors to consider the size, complexity, and risk profile of the financial institution when determining how such principles will be met.
- The term "Oversight Functions" now specifies that it includes Financial, Risk Management, Compliance, Internal Audit, and Actuarial, and the Revised Guideline now specifies a functional reporting line rather than a direct one with respect to the principle that the Oversight Function is to remain independent from operational management.

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- Greater clarity is now provided in connection with distinguishing between board and senior management responsibilities.
- OSFI expects the process and criteria used in the selection process for board and members of senior management to be disclosed to OSFI, along with information regarding candidate qualifications.
- Federally regulated financial institutions that are part of a larger corporate group (another federally regulated financial institution or company in Canada, or another company abroad), may be subject to or adopt certain policies of the parent.

Through the consultation process for the Revised Guideline, OSFI was requested by industry members to define certain terms, including: board independence, senior management, operational management, oversight functions, and certain terms used throughout the Revised Guideline pertaining to culture, oversight, sufficient stature and authority and diversity. In keeping with OSFI's principles-based approach, the Revised Guideline does not prescribe requirements for all institutions. Federally regulated financial institutions are expected to determine the appropriate application of the Revised Guideline, having regard to their individual circumstances.

Corresponding Changes to Related Guidelines

To ensure consistency with the Revised Guideline, OSFI is removing board requirements from its guidelines and advisories pertaining to risk management and capital and reissuing those guidelines and advisories.

Additionally, OSFI rescinded the *Advisory – Changes to the Membership of the Board and Senior Management* and revised its Composite Risk Rating and Assessment Criteria, to ensure that the foregoing complement the Revised Guideline.

OSFI has indicated that it also intends to review and amend OSFI Guideline E-4A: *Role of the Chief Agent & Record Keeping Requirements* and OSFI Guideline E-4B: *Role of the Principal Officer & Record Keeping Requirements* in the near future.

In addition to streamlining OSFI's guidelines and advisories with respect to corporate governance and board expectations into one document, the Revised Guideline seeks to permit flexibility for federally regulated financial institutions to meet corporate governance expectations having consideration to the institution's size, risk factors and the nature of its business.

Summary

OSFI has not adopted a "fit and proper" approach to approving individual directors. This approach is commonly used in the UK and other jurisdictions. It allows a regulator to have much more control over who may be appointed to the board of directors of a financial institution. The approach taken by OSFI in the

Revised Guideline is principles based and allows more flexibility to federally regulated financial institutions regarding the composition of their boards. It is likely that OSFI will still continue to provide their views to federally regulated financial institutions regarding the suitability of directors as well as skills that may be missing on a board of directors. However, OSFI's views will be provided on an informal basis.

The completion of the Revised Guideline now allows OSFI to turn to the corporate governance requirements for the branch operations of foreign banks and foreign insurance companies. OSFI has deliberately delayed the preparation of revised corporate governance requirements for foreign branches until sometime next year. OSFI wanted to wait until the Revised Guideline was completed so that provisions in it that were also applicable to foreign branches could be included. OSFI has in the past relied on the regulator in the home jurisdiction of a foreign bank or foreign insurer to be responsible for corporate governance. It will be interesting to see the types of corporate governance requirements that OSFI decides to make applicable to branch operations.

One concept that OSFI may require is the formation of a Canadian Branch Management Committee that would function in a manner similar to a board of directors. Although members of the Committee would not have the same legal responsibilities or liabilities as directors, they would still provide oversight and control to a branch operation.

The Revised Guideline is the result of a long consultation process with banks and insurance companies. OSFI considered a number of different approaches to regulating a board of directors. The Revised Guideline reflects OSFI's position that it is a principles-based, and not a rules-based, regulator. The Revised Guideline is an important guideline that provides OSFI's expectations regarding suitability of directors and how boards of directors should operate in the future.

For more information, please contact any member of our Insurance & Reinsurance Group.

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