Enhancing Consumer Protection In Canada
2019 Bank Act Revision

"In the Twitterverse, the discussion of culture in financial institutions is dominated by concerns about cultures that tolerate misconduct."
Jeremy Rudin, head of the OSFI, June 17, 2015 [i]

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We are jointly responding to the August 26, 2016, *Consultation Document* (**Green Paper**) *for the Review of the Federal Financial Sector Framework*. We both consent to the disclosure of our submission in whole or in part. We also ask that our identity and any personal identifiers be removed prior to publication.

We are expressing our personal views, as consumers of financial services who have a keen interest in the 'utility' core objective of the needed reforms. We fully agree with the Green Paper's statement that *"In all cases, consumers are looking to be treated fairly."* (at page 26). We are filing this submission because the bank's misconduct risks become the customers' risks too. In the market conduct areas, focus is not on the financial condition of banks, but on their behaviour and information provision in relation to customers and the market at large.

We believe that paragraphs (c) and (e) of the new Bank Act section 627.02, proposed by Bill C-29 of the Government of Canada, properly reflect principles 3 and 6 - ***Fair Treatment of Consumers*** and ***Responsible Business Conduct*** respectively - of the 2011 *G20 High-Level Principles on Financial Consumer Protection* which are being adopted by a growing number of jurisdictions around the globe.

The mission of the Institute of International Finance (IIF) is to advocate for regulatory, financial and economic policies that are in the broad interests of its members. The majority of the IIF's membership are commercial banks, and Canada's largest banks are all IIF members. In its June 2013 paper entitled *Promoting Greater International Regulatory Consistency* the IIF contended that the industry needs to refrain from encouraging inconsistency and concluded:

> *"Regulators and other policymakers face a choice between working with each other to a much greater extent than before, and going down an increasingly national route to regulation and supervision. Not only would such a route impact companies, investors, and customers, it would not even be compensated by an increase in financial stability. The question is not whether policymakers can afford to commit the time and resources to greater international cooperation and coordination, but whether they can afford not to."* [ii]

In an interview with CBC News chief correspondent Peter Mansbridge held on December 16, 2015, in London, U.K. regarding misconduct in the financial sector, Canada's Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board (FSB), said *"Markets need structure.* ***You can't just leave the market to itself****. It has to have proper rules that govern behaviour in the market and the consequences for individuals and for institutions of going offside of those rules"* (emphasis added).[iii]

In this submission, we have limited our comments to five 'efficacy' concerns we have, namely, (i) "inconsequential" breaches of ethical standards, (ii) outdated corporate governance guidance, (iii) accountability and weak staff training, (iv) perplexing handling of market conduct, and (v) badly needed enhanced supervisory regime.

I - "Inconsequential" Breaches of Ethical Standards

We are highly sceptical of the self-serving arguments and supporting public opinion survey put forward by the Canadian Bankers Association in its February 28, 2014 submission to Finance Canada where the industry association strongly reject a fairness regime that is structured by regulation, in essence maintaining the status quo and advocating inconsistency. However, the initiative of individual Canadian banks to voluntarily make fairness an integral part of their respective code of conduct is to be commended. A legislated requirement to treat customers fairly is simply a formalization of the concern for their clients that most domestic banks, if not all, have always shown and a reminder not to abandon that concern in stressful times.

The current mandate of the Financial Consumer Agency of Canada (FCAC) is to monitor compliance with the designated "consumer provisions" of the Bank Act. Born out of a 1998 Task Force on the Future of the Canadian Financial Services Sector, which studied the effect of large bank mergers, the agency was created to oversee the interests of bank customers from coast to coast to coast, who at the time were seen as inadequately represented by the OSFI. The current consumer protection framework predates the 2007-2008 financial crisis by almost a decade and is in bad need of modernization. At present, compliance failure with a voluntary code of conduct cannot be enforced by the FCAC. Unlike treatment of non-compliance with a legislated

consumer provision, breaches of a code are not subject to administrative monetary penalties and do not form part of the bank's compliance history. Violations of voluntary codes of conduct, including the most serious breaches, are without regulatory consequences.

It is highly deplorable that recently more than 5,300 employees of Wells Fargo in the United States felt comfortable breaching the ***Deal Fairly with Customers*** standards of the bank's code of ethics and the bank's responsible business conduct policy. [iv]

II - Outdated Corporate Governance Guidance

Recent cases of misconduct have been identified as stemming from:

- mis-selling financial products to retail and business clients;
- violating national and international rules in regard, for instance, to tax evasion, anti-money laundering, anti-terrorist financing, and economic sanctions;
- manipulating financial markets, such as Libor rates and/or foreign exchange rates; and
- getting a bigger share of the customers' wallets – **Abuse of financial services**, which is Principle 29 of the September 2012 *Basel Core Principles for Effective Banking Supervision.* [v] The first part of it reads as follows *"The supervisor determines that banks have adequate policies and processes, including strict customer due diligence rules to promote high ethical and professional standards in the financial sector."*

In response, international standards setting organizations have agreed for financial stability purposes that going forwards the regulatory/supervisory focus must be on ethical behaviour and written codes of conduct intended to foster and maintain a culture of integrity, fairness and accountability to protect the interest of customers and other stakeholders. This is a movement the head of the OSFI has rightly entitled ***Away from the lamppost*** in regard to culture, conduct and effectiveness of prudential regulation.[vi]

Conduct risk has been defined by the International Association of Insurance Supervisors to mean:

> *"The risk to customers, insurers, the insurance sector or the insurance market that arises from insurers and/or intermediaries conducting their business in a way that does not ensure fair treatment of customers."* [vii]

The same high-level description of conduct risk applies equally to the banking industry across countries.

OSFI's current *Corporate Governance Guideline* was last updated in 2012. The words 'ethics', 'ethical', 'fairness' or 'fair treatment of customers' are nowhere to be found. It contains only a single reference to 'code of conduct'. In fact, this outdated federal guideline preceded the recent spate of misdeeds involving a significant number of large banks (some of them operating in

Canada) and huge fines exceeding $235 billion in aggregate [viii] We are particularly concerned that these fines (a) relate to banking activities that took place after the 2007-2008 financial crisis, and (b) are treated internally by the banks as simply a cost of doing business to ultimately be paid by customers.

By way of contrast, the more modern *Basel Committee Guidelines on governance principles for banks* (July 2015) has more than half a dozen provisions dealing with corporate matters related to ethics and codes of conduct.[ix] Here are a few exemplary ones that should be integrated into the Canadian supervisory framework for consistency purposes and enhanced consumer protection:

Reinforcing Responsible Business Conduct (Commercial) Practices

A fundamental component of good governance is a corporate culture that reinforces appropriate norms for responsible and ethical behaviour. These norms are especially critical in terms of a bank's risk awareness, risk-taking behaviour and risk management (i.e., the bank's "risk culture") - Principle 29.

Making Staff Aware of Corporate Values and Discipline

In order to promote a sound corporate culture, the board of directors should reinforce the 'tone at the top' by confirming that (a) appropriate steps have been or are being taken to communicate throughout the bank the corporate values, professional standards and codes of conduct it sets, together with supporting policies, and (b) employees, including senior management, are aware that appropriate disciplinary or other actions will follow unacceptable behaviours and transgressions - Principle 30.

Defining Acceptable and Unacceptable Behaviours

A bank's code of conduct or code of ethics, or comparable policy, should define acceptable and unacceptable behaviours. It should explicitly disallow illegal activity, such as financial misreporting and misconduct, economic crime including fraud, breach of sanctions, money laundering, anti-competitive practices, bribery and corruption, or the violation of consumer rights (e.g., fairness) - Principle 31.

Undoubtedly, the above mentioned principles, among several other sound practices, would help the FCAC – which at present does not provide corporate governance guidance - to administer the necessary consumer provision found in subsection (2) of the new Bank Act section 195.1 regarding *Directors' report to the Commissioner*. In our view, this annual market conduct report would be of crucial importance to effective supervision and, consequently, it would have to be comprehensive. Collecting data on banks from across the country regarding their treatment of customers, corporate culture, and practices in the market would be vital.

III - Accountability and Staff Training

Pursuant to the FSB, accountability is a fundamental element of a sound risk culture. In its April 2014 *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture*, the FSB explains that accountability is achieved when relevant employees at all levels understand the core values (fairness included) of the bank and its approach to risk, are capable of performing their prescribed roles, and are aware that they are held accountable for their actions in relation to the bank's risk-taking behaviour.[x]

The blue-ribbon Group of Thirty (G-30) highlighted in its 2012 report *Toward Effective Governance for Financial Institutions* that **'customer-centricity'** is among the four aspects of corporate culture that have special relevance to governance effectiveness; the other three being risk culture, performance culture, and societal responsibility. According to the G-30, the code of conduct should emphasize the positive commercial benefits of high standards of ethical business conduct and not simply the negative consequences of getting things wrong. We share their view that constant reminders and repetition are the keys to embedding a culture.[xi]

Financial consumers around the world were troubled by the findings of a 2013 global survey, Canada included, that were made public by the Economist Intelligence Unit under the heading ***A crisis of culture**: Valuing ethics and knowledge in financial services*.[xii] The report showed that ethical conduct might still not be an entirely natural fit within financial services, where the majority of respondents (53%) think that career progression would be difficult without being "flexible" over ethical standards; this rises to close to three-quarters (71%) of investment bankers taking the survey. Moreover, 53% of respondents say that rigid adherence to ethical standards would damage the firm's competitiveness. Obviously, many executives are struggling to see the benefits of greater adherence to ethical standards. In consequence, their financial institutions don't compete on merits.

Three years later in a special publication entitled *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reforms* dated July 2015, the same G-30 made a number of valuable recommendations regarding staff development emphasizing that (a) banks should continue to build and implement robust processes to explain and regularly reinforce to staff what is expected of them, and (b) promotion should be awarded only to those who have consistently exhibited commitment to firm values and desired behaviours.[xiii] We believe that simply declaring that the fair treatment of customers principle and related consumer provisions will be complied with, as required by paragraphs (a) and (b) of the new Bank Act subsection 195.1 (1), but failing to give them any weight in incentive and promotion decisions, sends a message that culture and values do not matter.

OSFI's Assistant Superintendent, Deposit-Taking Institutions, said on May 5, 2016, in a speech about *Risk Awareness: Finding the Risks Before They Find You* - *"But even with the heightened awareness and attention on financial institutions, financial institutions still behaved in a manner that exposes them to prudential and **reputational risk**; exposure that can damage an*

institution's reputation and relationships with its customers, ultimately affecting its bottom line." (emphasis added).[xiv]

We are delighted by the regulation making authority provided by paragraph (b) of the new Bank Act section 627.96 respecting the training of a bank's employees, representatives, agents or other intermediaries. However, we are concerned by the lax supervision showed by OSFI in regard to reputational risk management. To the best of our knowledge, the most recent reported review of reputation risk practices dates back to June 2005.[xv] With respect to training programs, OSFI reported then that more could be done in regard to codes of conduct. As a next step, the federal prudential regulator indicated it would continue to pay increasing attention to how financial institutions manage all aspects of reputational risk.

By comparison, the latest review by Quebec's Autorité des marchés financiers (AMF) regarding codes of conduct (of 219 insurers licensed to operate in the province) is dated July 2015. The results showed there is room for improvement.[xvi]

IV - Perplexing Handling of Market Conduct

"Market conduct in particular in the banking industry is a big issue" said former Superintendent Julie Dickson, as reported in the OSFI Pillar of Winter 2014.[xvii]

In sharp contrast, the FCAC's 2015-2016 annual report indicates that the agency has observed, *"strong market conduct"* among federally regulated banks and insurers. The report also points out that the federal market conduct regulator's compliance efforts have uncovered *"no major or systemic concerns."* [xviii]

This troublesome disconnect really casts a serious shadow on the real value of the federal Financial Institutions Supervisory Committee pertaining to consumer protection.

Close coordination between the prudential and market conduct regulators at the federal level is critical to achieving the overall objectives of banking supervision, including striking an appropriate balance between the supervisory objectives of prudential and market conduct supervision, and to avoid dual compliance with two levels of government and related paramountcy issues.

A second concern we have is the confusing categorization or classification of conduct risk within the OSFI's existing *Supervisory Framework*.

The federal prudential regulator does not view reputational risk as an issue in its own right but simply as a consequence of other risks. Yet, it is generally recognized that customers are the most important stakeholders when it comes to managing reputational risk. In fact, most, if not all, domestic banks have made their code of conduct their roadmap to maintaining their reputation. According to the 2014 global survey on reputation risk published by Deloitte, the top driver of reputation risk is any risks related to ethics and integrity.[xix]

Whereas unethical behaviour is considered a people risk for the purposes of OSFI Guideline E-21 on operational risk management, reputational risk is (by contradiction) specifically excluded. In addition, there are two incoherent definitions of "regulatory compliance risk", one in the OSFI's *Supervisory Framework* that encompasses non-conformance with ethical standards, and the other in OSFI Guideline E-13 on regulatory compliance management where breaches of ethical standards are kept out. This is confusing for accountability purposes.

Given that unethical practices are the biggest source of reputational risk, we are of the view that "reputational risk" should be a class in its own right, as is the case in Quebec since 2014 where the definition reads: *"Reputational risk is the current and prospective impact on the institution's business conduct arising from negative public opinion."* [xx]

V - Badly Needed Enhanced Supervisory Regime

We strongly contend that enhancing consumer protection without a corresponding enhancement in the FCAC's legislated objects is passive and dangerously too modest.

A Bay Street lawyer (unnamed) with extensive dealings with the FCAC is reported in the Financial Post of May 1, 2014, to have said *"They* (the FCAC) *could be a stronger regulator. I don't think they've been too aggressive on the banks and although they started out gangbusters, over the years it has become more benign."* This lawyer went on to add *"The banks are walking a fine line because they don't want to abide by 13 different provincial and territorial codes but at the same time,* ***they don't want the new federal code to be too aggressive****"* *(emphasis added).*[xxi]

Contrary to opinions on Bay Street, the business of banking (of exclusive federal authority) is not "everything a bank does". Promoting insurance, trading in securities, managing risk, dealing in real property, estate planning services, processing data, and offering consumers safety deposit box services, to name a few, are not "banking". Unanimous decisions of Canada's highest tribunal support this viewpoint.[xxii]

In a drafting note in its proposed *Supervisory Framework* the FCAC indicates that future guidance will explain expectations of banks for compliance management and governance in relation to misconduct risks such as treating customers unfairly or violating other specific consumer provisions.[xxiii]

Pursuant to its governing legislation - FCAC Act subsection 3(2) - the agency's mandate is restricted to determining by means of supervision whether the bank is in compliance with the applicable consumer provisions. Unlike OSFI, the FCAC is not empowered to do risk assessment to determine whether the bank's business conduct (commercial) practices are sound. Unfortunately, no changes are proposed by Bill C-29 to ensure the FCAC's objects are equivalent to those of OSFI Act subsection 4(2) for effective supervision. This state of affairs creates an uneven "twin peaks" system of federal regulation as well as an incentive for the provinces to fill in the gaps.

In the aftermath of the financial crisis, the need for more effective supervision was identified by the FSB and the G20 Leaders (Canada included) as a priority.

The (revitalized) purpose of supervision is not to pursue sanctions (a reactive approach), but rather to resolve situations and problems (a proactive approach) that could otherwise force costly intervention (using taxpayer money). Any consumer protection framework needs to be created carefully. More general rules, such as a duty of fairness, require more analytical, risk-based supervision while more detailed rules (e.g., cost of borrowing disclosure) basically correspond to simpler, more conventional supervision that focuses on verifying compliance. Moreover, supervisors/regulators need to be willing and prepared to have a high-level dialogue in regard to governance, risk assessment, and behaviour - a dialogue that is different from the one on compliance. Although important, fair treatment needs more than just good disclosure.

With respect to responsible business conduct, banks should actively seek out tomorrow's problems and resolve them today. Supervision of market conduct should not only be about "ticking off" fulfilment of the literal content of regulations (the letter of the law), but also ensuring that the public policy goal of the regulations (the letter of the law) is met. We have noted that this responsibility is already enshrined in most, if not all, codes of conduct of Canadian banks together with an obligation to report misconduct internally.

The first words of the December 3, 2013 government News Release accompanying the initial proposal for a new consumer code for Canada read *"A strong financial system is one in which consumers are confident that their interests are well protected by a high-quality regulatory framework."* [xxiv]

We challenge all five of the CBA's arguments that the proposed fair treatment regime would (i) *"weaken banking policy"*, (ii) *"not be helpful"*, (iii) *"have inappropriate consequences"*, (iv) *"be expensive, complex and difficult"*, and (v) *"limit consumers' convenience and ability to access products and services over the phone or online, or to purchase products or services jointly with another person, given the information that a bank would need to collect for the purpose of administering a fair treatment regime."* [xxv]

We strongly believe that a financial consumer protection regime that is:

1. **not fixed in detailed regulations i.e., more organic than static, offering fewer points in gaming the system through legal opinions (like the current prudent portfolio approach for investment and lending activities);**
2. **aligned with corporate governance at the highest levels;**
3. **unequivocally tied to business conduct risk;**
4. **proactive in preventing or solving issues;**
5. **not exclusively relying on disclosures, accessibility, complaint resolution, fraud prevention and financial literacy;**
6. **underpinned by a statutory fairness principle that is internationally accepted as a general expectation for the responsibilities banks have to their customers;**

7.	**able to deal with problems that may affect multiple clients at one time, rather than dealing with them solely on a case by case basis;**
8.	**conducive to an early identification of potential systemic risks that have their roots in poor conduct practices;**
9.	**providing greater opportunities for banks to interact with the regulator in achieving consumer-oriented outcomes; and last but not least**
10.	**fostering more effective customer engagement away from "you're wrong I'm right" type of discussions,**

is a regulatory regime that is far superior to what is now in place and delivers more public value.

In our view, this superiority alone should reduce any reasons the provinces or territories may have to subject banks to dual compliance in the market conduct field, particularly, if as a result of Bank Act amendments and consequential legislative changes, the FCAC becomes a stronger regulator. The paramountcy provision found in the new Bank Act subsection 627.03(2) may rest in peace for decades to come, saving banks a lot of money in legal fees, judicial proceedings, and undesirable publicity.

In the latest independent research exploring bank impressions of OSFI (reported in May 2016) much of the commentary regarding supervision is very positive - *"In its supervisory role, OSFI is described as professional, encouraging open dialogue, focusing on the appropriate areas of risk, and, understanding the nature of the institutions it regulates."* [xxvi] Once a more modern framework is established for market conduct regulation and supervision in regard to banking products and services, we believe the FCAC could achieve an equivalent evaluation.

Conclusion

When the G20 Leaders first met in November 2008 to discuss the root causes of the 2007-2008 financial crisis, action plans and common principles for reform, they committed to promote integrity in financial markets by *"bolstering investor and consumer protection"*.[xxvii] We query why it took eight years for the federal government to propose a Financial Consumer Protection Framework i.e., the new Bank Act part XII.2 and related amendments, which have yet to be enacted. We hope that Canada will not be the last of the G20 countries to adopt banking legislation that is in sync with the G20 high-level principles on fair treatment of consumers and responsible business conduct.

Federally regulated insurance companies are already subject to these internationally agreed principles via the framework for cooperative market conduct supervision in Canada that was developed by the Canadian Council of Insurance Regulators (CCIR) to reflect the evolution/modernization of market conduct supervision. With respect to insurance products and services, the CCIR cooperative framework:

- provides customers and the public with uniform protection on a pan-Canadian level;

- allows the institution to carry on the business of insurance, consistently and efficiently across Canada; and
- ensures the uniform supervision of institutions and enforcement of provisions relating to the protection of their customers and the public.

With a view to saving time for the benefit of customers of banking products and services, we ask that Bill C-29 be adopted in advance of the quinquennial Bank Act revision scheduled for 2019 and ahead of the detailed assessment of observance of Basel Core Principles for effective banking supervision in Canada that will soon be undertaken by the International Monetary Fund.

We are of the opinion that the Government of Canada's goals, first set in its *Economic Action Plan* 2013, to create a comprehensive financial consumer code have been met.[xxviii]
Congratulations!

Please do not hesitate to contact us should you need clarification or additional information regarding our comments, views and suggestions.

[i] http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jr20150617.aspx

[ii] https:www.iif.comsystemfiles2013_06_IIF_PromotingGreaterInternationalRegulatoryConsistency_1.pdf (at page 28)

[iii] http://www.cbc.ca/news/mark-carney-bank-of-englandpetermansbridge-1.3368640

[iv] https:/www08.wellsfargomedia.com/assets/pdf/about/corporate/code-of-ethics.pdf (at page 14)

[v] http://www.bis.org/publ/bcbs230.pdf

[vi] http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jr20150617.aspx

[vii] http://www.iaisweb.org/file/52875/issues-paper-on-conduct-of-business-risk-and-its-management (at page 6)

[viii] http://graphics.thomsonreuters.com/15/bankfines/index.html

[ix] http://www.bis.org/bcbs/publ/d328.pdf

[x] http://www.fsb.org/wp-content/uploads/140407.pdf (at page 3)

[xi] http://group30.org/images/uploads/publications/G30_TowardEffectiveGovernance.pdf (at pages 78 and 80)

[xii] https://www.cfainstitute.org/about/research/surveys/Documents/crisis_of_culture_report.pdf

[xiii] http://group30.org/images/uploads/publications/G30_BankingConductandCulture.pdf (from page 50)

[xiv] http://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/sp-ds/Pages/jh20160505.aspx

[xv] http://www.osfi-bsif.gc.ca/eng/fi-if/in-ai/Pages/rep_risk.aspx

[xvi] https://www.lautorite.qc.ca/files/pdf/professionnels/assureurs/results_practices_self_assessment.pdf

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[xviii] http://www.fcac-acfc.gc.ca/Eng/about/planning/annualReports/Documents/FCAC-annual-report-2015-16.pdf

[xix] https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Governance-Risk-Compliance/gx_grc_Reputation@Risk%20survey%20report_FINAL.pdf

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[xx] *https://www.lautorite.qc.ca/files/pdf/reglementation/assurances-inst-depot/cadre-surveillance-2014-an.pdf*

[xxi] http://business.financialpost.com/executive/executive-women/lucie-tedesco-fcac

[xxii] http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/2362/index.do

[xxiii] http://www.fcac-acfc.gc.ca/Eng/forIndustry/publications/consultations/Pages/supframe-cadrecon.aspx#s22

[xxiv] https://www.fin.gc.ca/n13/13-158-eng.asp

[xxv] https://www.fin.gc.ca/consultresp/fcpf-cpcpsf/073-fcpf-cpcpsf.pdf

[xxvi] http://epe.lac-bac.gc.ca/100/200/301/pwgsc-tpsgc/por-ef/office_superintendent_financial/2016/020-15-e/report.html

[xxvii] http://www.g20.utoronto.ca/2008/2008declaration1115.html

[xxviii] https://www.fin.gc.ca/activty/consult/fcpf-cpcpsf-eng.asp