

OSFI TO REQUIRE ADVANCE NOTIFICATION OF CHANGES TO BOARD MEMBERSHIP/SENIOR MANAGEMENT

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On January 20, 2014, the Office of the Superintendent of Financial Institutions Canada (OSFI) issued a draft advisory entitled *Changes to the Membership of the Board and Senior Management*. The draft advisory applies to all federally regulated financial institutions (FRFIs)^[1] including insurers. Interested parties have until February 28, 2014 to provide comments for OSFI's consideration.

The draft advisory reportedly finds its genesis in statements contained in OSFI's revamped [Corporate Governance Guideline](#) to the effect that FRFIs should notify OSFI whenever changes to board membership or senior management are contemplated and if circumstances arise that could adversely affect the suitability of existing directors or senior management. The draft advisory is stated to be an effort to formalize the existing requirements with respect to board and senior management changes.

The *Corporate Governance Guideline* was finalized in early 2013 and was largely based on emerging international best practices in the regulation of financial institutions. The notification requirements contained in the draft advisory are consistent with the *Insurance Core Principles, Standards, Guidance and Assessment Methodology* of the International Association of Insurance Supervisors ([IAIS Core Principles](#)), in particular, ICP 5 "Suitability of Persons". Section 5.4 states:

"The supervisor [i.e. the regulator] requires to be notified by insurers of any changes in Board Members, Senior Management, Key persons in Control Functions and Significant Owners, and of any circumstances that may materially adversely affect the suitability of its Board Members, Senior Management, Key Persons in Control Functions and Significant Owners."

Similarly, *Principle 14: Corporate Governance* of the *Core Principles for Effective Banking Supervision* established by the Basel Committee on Banking Supervision ([Basel Core Principles](#)) states as an "Additional Criterion":

"Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management."

OSFI's draft advisory concentrates on the pre-notification requirement and, except for a passing reference, does not stipulate any requirements, including for timing or form of notification, in circumstances where a board member's or senior manager's suitability may have been adversely affected. Both the draft advisory and the accompanying cover letter indicate that the purpose of the advisory is to outline the process for notifying OSFI of potential changes in board membership or senior management. It does not purport to mandate notification of an individual's loss of suitability.

In summary, the draft advisory requires FRFIs to:

- pre-notify OSFI in writing as soon as a new nominee to the board of directors is identified
- pre-notify OSFI in writing at least 30 days in advance of the appointment of a senior manager
- in each case, as part of the written notification, provide OSFI with:
 - the candidate's curriculum vitae, demonstrating the candidate's overall suitability
 - the rationale for the candidate's selection
 - the proposed effective date of the appointment
- when available, provide OSFI with:
 - a draft copy of the internal and/or public announcement regarding the appointment
 - the results of the FRFI's assessment of the candidate in accordance with [Guideline E-17 – Background Checks on Directors and Senior Management of FREs](#)

OSFI acknowledges that the individuals that comprise "senior management" may vary depending on the institution. Generally, senior management will include the Chief Executive Officer and individuals reporting directly to him or her, and possibly heads of major business platforms or units. Senior management may also include the heads of all "oversight functions" namely, the Chief Financial Officer, Chief Risk Officer, Chief Compliance Officer, Chief Internal Auditor and Chief Actuary.

Essentially, existing Guideline E-17 requires FRFI's to adopt policies and procedures for assessing the suitability and integrity of "Responsible Persons", including verifying the individual's credentials and conducting criminal background and similar checks initially upon appointment and ongoing assessments to ensure continued suitability at intervals during the individual's tenure. For example, criminal background checks are required to be conducted at least once every seven years.

Although Guideline E-17 indicates that OSFI may review a FRFI's background assessments of directors and senior managers and possibly conduct its own independent review, that guidance left the obligation to assess suitability and integrity to the FRFI. The new draft advisory introduces a positive obligation upon FRFI's to inform OSFI of these matters (and will have the added effect of ensuring that FRFIs are strictly complying with the background assessment requirements of Guideline E-17).

The draft advisory states that "To the extent that OSFI may have any specific concerns regarding the appropriateness of a candidate, OSFI will inform the Board of the FRFI, as appropriate, prior to the candidate's appointment or nomination for election." Although it does not go so far as to require OSFI's pre-approval to new board members and senior officers, the advisory essentially provides OSFI with a veto.

The draft advisory also introduces the concept of OSFI-initiated meetings between designated OSFI officials and the new director or senior manager within four to six months after the individual has been appointed. Whether or not such meetings will take place appears to be at OSFI's discretion but the meetings are stated to be applicable, by way of example, to domestic systemically important banks.^[2] In addition to a "meet and greet" the purpose of the meeting is to provide OSFI with an opportunity to drive home the individual's statutory duties as well as OSFI's expectations under the *Corporate Governance Guideline*, including "a Board's duty to inform OSFI of substantive issues affecting the FRFI".

The advisory clarifies that the pre-notification requirements are not to replace the FRFI's other statutory notification requirements, for example, filings that are required to be made within 15 days after changes occur in directors and senior officers (after the fact).

OSFI currently has the statutory right to receive pre-notification of the appointment of directors and senior officers, but only in circumstances where the institution is subject to some form of regulatory intervention.^[3] Some institutions may have an established practice of advising their OSFI relationship manager prior to a significant change or appointment, as a courtesy and in furtherance of cooperation and transparency. Regardless, the draft advisory purports to advance OSFI's regulatory reach beyond current statutory boundaries, just as other OSFI corporate governance initiatives have done for some time. By way of example, for banks and insurers, statutory committees include the Audit and Conduct Review committees. By means of guidance over the years, requirements for committees has increased to include Corporate Governance and Risk. In addition, the roles of Compliance Officer and Risk Officer are similarly creatures of guidance and not the statutes.

It is important to note that OSFI's existing statutory powers to obtain pre-notification are subject to a framework for due process. For example, the statutes establish criteria upon which a decision by OSFI to disqualify a candidate must be based, and affords the candidate and the FRFI an opportunity to be heard. By contrast, the draft advisory is silent on these matters.

The draft advisory ends on a somewhat ominous note, by reminding FRFI's of OSFI's broad statutory powers to collect information "...at such times and in such form as the Superintendent may require" and existing powers to disqualify or remove directors and senior officers.

Assuming the advisory is adopted without material amendment, as a practical matter, FRFI's should conduct

important and potentially sensitive background assessments prior to initial submission of the candidate's name to OSFI and, of course, obtain prior consent to disclosure of personal information. In addition, offers of employment should be conditional upon OSFI's non-objection to the individual's appointment.

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[1][ps2id id='1' target=''] Banks, Bank Holding Companies, Trust and Loan Companies, Cooperative Credit and Retail Associations, Life Insurance Companies, Fraternal Benefit Societies, Property and Casualty Insurance Companies and Insurance Holding Companies

[2][ps2id id='2' target=''] In March, 2013, OSFI identified Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada, and Toronto-Dominion Bank (Canada's six largest banks) as domestic systemically important banks.

[3][ps2id id='3' target=''] See, for example, section 678.1 of the *Insurance Companies Act* and section 647 of the *Bank Act*.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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