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OFFICE OF THE
Auditor General
of British Columbia

**Monitoring Credit Unions
and Trust Companies
in British Columbia**

Canadian Cataloguing in Publication Data

British Columbia. Office of the Auditor General.

Monitoring credit unions and trust companies in British Columbia

(Report ; 2000/2001: 5)

ISBN 0-7726-4421-7

1. British Columbia. Financial Institutions Commission – Evaluation. 2. Credit unions – British Columbia – Auditing. 3. Trust companies – British Columbia – Auditing.

I. Title. II. Series: British Columbia. Office of the Auditor General. Report ; 2000/2001: 5.

HG2039.C3B74 2001

334.22'09711

C00-960377-8



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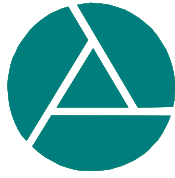
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OFFICE OF THE
Auditor General
of British Columbia

The Honourable Bill Hartley
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
V8V 1X4

Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2000/01 Report 5: Monitoring Credit Unions and Trust Companies in British Columbia.

Wayne Strelloff, CA
Auditor General

Victoria, British Columbia
March 2001

copy: Mr. E. George MacMinn, Q.C.
Clerk of the Legislative Assembly

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auditor general's comments



Approximately \$28 billion is on deposit with credit unions and trust companies in British Columbia, compared to some \$62 billion on deposit with banks in the province. The Financial Institutions Commission (FICOM) carries the responsibility for monitoring credit unions and trust companies for compliance with the Financial Institutions Act and the Credit Union Incorporation Act. This report looks at whether FICOM was adequately monitoring credit unions and trust companies for compliance with those Acts during 1999.

Overall, we found that they were. While we have made a number of recommendations, our only significant concern is over the monitoring of the market conduct requirements of the Act (the requirement to disclose the name of the financial institution in all material relating to transactions with customers and in all advertizing, the prohibition on tied selling, and the requirement to keep confidential all customer information) as they apply to extra-provincial trust companies, those trust companies which are incorporated either federally or in other provinces and which have branches in this province. The primary regulator of most of these extra-provincial trust companies is the federal regulator, but we learned that, as yet, the federal regulator has no mandate to review market conduct.

FICOM monitors the market conduct requirements by following up on complaints and by performing various procedures during their visits to credit unions and trust companies. However, in the case of extra-provincial trust companies, FICOM is not required to visit them and, because of finite resources, has chosen not. Instead, FICOM follows up on complaints that it receives. Our recommendation that FICOM visit these extra-provincial trust companies to monitor their market conduct is not based on any known problem, indeed FICOM does not receive many complaints in this area, but we do have a concern over the lack of regular monitoring by FICOM or the federal regulator.

It is to be hoped that a new federal financial institution consumer protection agency will have a role in market conduct regulation. But that will have to await its establishment.

I would like to thank the staff of the Financial Institutions Commission for their assistance to my own staff during this audit.

Wayne K. Strelloff, CA
Auditor General

Victoria, British Columbia
March 2001



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monitoring credit unions
and trust companies
in british columbia

highlights

Is the Financial Institutions Commission adequately monitoring credit unions and trust companies for compliance with the Financial Institutions Act and the Credit Union Incorporation Act?

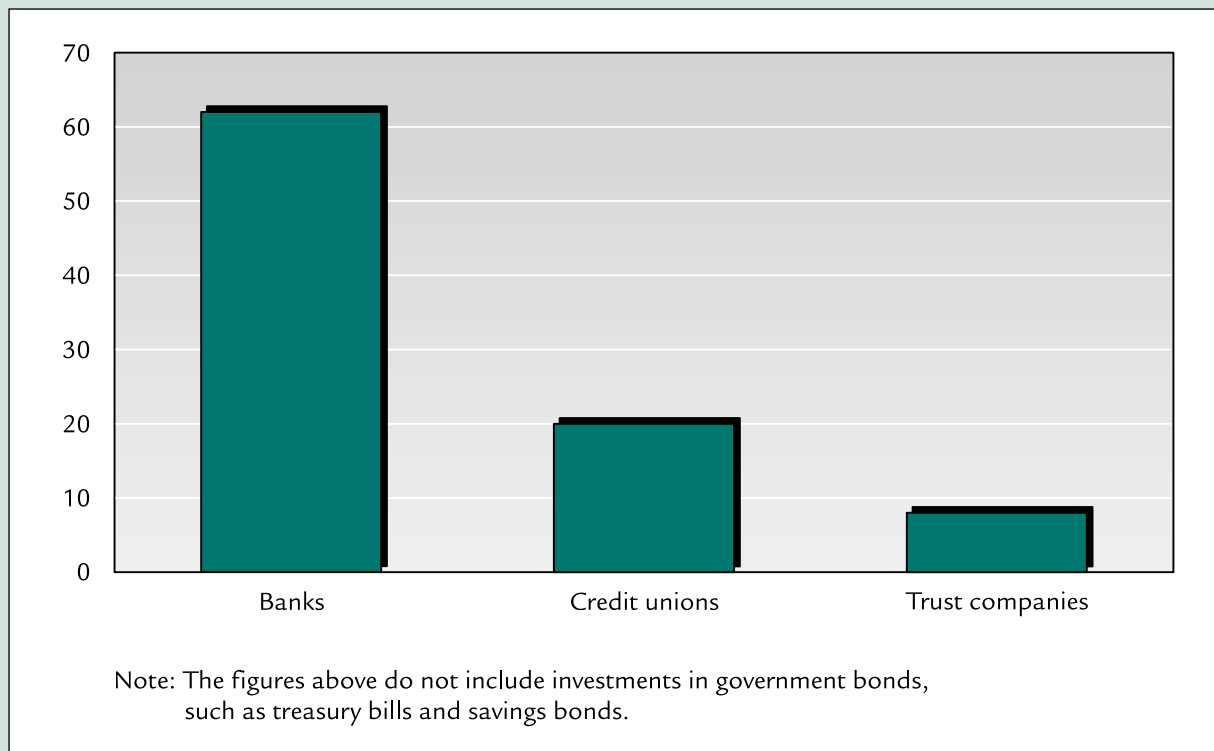
People looking for financial institutions to provide them with services such as chequing and savings accounts, loans and mortgages can go to banks, credit unions and trust companies.

In British Columbia, deposits with banks amount to \$62 billion, and deposits with credit unions and trust companies amount to \$28 billion (Exhibit 1). Banks are regulated by a federal government agency, credit unions are regulated by the provinces, and trust companies are regulated by both the federal government and the provinces, depending upon in which jurisdiction they are incorporated.

Exhibit 1

Deposits in British Columbia at banks, credit unions and trust companies third quarter

(\$ Billions)



Source: Compiled by the Office of the Auditor General from figures provided by the Bank of Canada and FICOM

In British Columbia, this responsibility is discharged by the Financial Institutions Commission (FICOM), an agency of the provincial government, whose regulatory work is the subject of this report.

This audit was limited to FICOM’s regulatory monitoring responsibilities for credit unions and trust companies under the Financial Institutions Act and the Credit Union Incorporation Act although, as explained in Exhibit 2, FICOM’s responsibilities extend to other statutes as well.

Exhibit 2

The Financial Institutions Commission (FICOM)

The Act requires that there be at least two but not more than 11 commissioners. The Chair of the commission is appointed by the Lieutenant-Governor in Council, the Deputy Minister of Finance is appointed to the commission by the legislation itself, and the Lieutenant-Governor in Council may appoint up to nine other commissioners. At the time of our audit there were nine commissioners in total—the Chair, the Deputy Minister and seven others.

The commissioners have two roles in the administration of the Financial Institutions Act, the Credit Union Incorporation Act, and the Community Financial Services Act: to provide recommendations to the Minister of Finance and Corporate Relations on major regulatory decisions related to in corporations, business authorizations, liquidations and wind-ups; and to make credit union stabilization, supervision and deposit insurance decisions. (Stabilization and supervision are regulatory powers used to assist credit unions that are experiencing financial or other difficulties.)

The commissioners have no legislative responsibilities with respect to the other statutes administered by FICOM.

FICOM staff are organized into six departments, all reporting to the Superintendent of Financial Institutions, who is also the Chief Executive Officer. These departments are:

- The Credit Unions and Trust Companies Department is responsible for making the day-to-day regulatory decisions under the Financial Institutions Act, the Credit Union Incorporation Act and the Community Financial Services Act.
- The Examinations Department is responsible for examining financial institutions for compliance with the regulations.
- The Insurance Department is responsible for making the day-to-day regulatory decisions under the acts relating to insurance companies.
- The Investigations Department is responsible for investigating statutory breaches of all acts administered by FICOM, as well for undertaking investigations into criminal matters.
- The Real Estate and Mortgage Brokers Department is responsible for making the day-to-day regulatory decisions under the Real Estate and Mortgage Brokers Act, and for providing information and assistance under the Condominium Act.
- The Administration Department provides support to the other departments, including accounting, general administration, human resources, information services, policy analysis and systems.

Source: Compiled by the Office of the Auditor General from the Financial Institutions Act and information provided by FICOM

The regulatory rules for credit unions and trust companies are designed to:

- protect depositors against insolvency of credit unions or trust companies;
- safeguard consumers against improper market conduct; and
- ensure that credit unions and trust companies have deposit insurance.

The Financial Institutions Act is the main piece of legislation that regulates credit unions and trust companies in British Columbia. It establishes FICOM and gives it the authority and responsibility to regulate all aspects of credit unions and trust companies.

The legislation requires FICOM to carry out examinations of credit unions and those trust companies incorporated in British Columbia at least annually; and permits FICOM to take enforcement action when necessary.

The Credit Union Incorporation Act specifies how credit unions may incorporate, and also regulates their acquisition, amalgamation and dissolution. It also defines the criteria for membership in the credit union, and regulates shares, voting rights, management, hearings and appeals, offences and penalties. And, this Act gives FICOM the authority to enforce its requirements.

FICOM does not guarantee that consumers will never experience losses that may result from the failure of a credit union or trust company. However, the legislative requirements, along with FICOM's extensive monitoring of the industry, reduce the risk of insolvency of credit unions and trust companies in British Columbia.

Audit Purpose, Scope and Approach

The Financial Institutions Act and the Credit Union Incorporation Act set out a regulatory framework designed to ensure that depositors are protected against insolvency and insured against losses, and that consumers are protected against improper market conduct in their dealings with credit unions and trust companies.

The purpose of our audit was to assess whether FICOM was adequately monitoring credit unions and trust companies in British Columbia, in the 1999 calendar year, to verify that they were complying with this regulatory framework.

What are credit unions and trust companies?

Credit unions

Credit unions began as an alternative to the federally chartered banks. They occupy a unique place in the Canadian financial services industry and offer a full range of financial services, just as chartered banks do. In contrast to the banks, credit unions are owned by their members, and have often played an essential role in the smaller or more remote communities, where banks are reluctant to establish branches. Also, there are large credit unions in the cities in British Columbia, which compete directly with the banks and other financial institutions.

Most credit unions were initially created to serve a group of members who had a mutual interest. Each credit union must have a "common bond" of membership based on only one of the following: religious interest; ethnic interest; social interest; occupation; employment; community; geographic area. However, a credit union can also accept as a member anyone residing in British Columbia whom the Credit Union can conveniently serve.

All credit unions are incorporated provincially, and they may only have branches in the province in which they are incorporated.

Trust companies

Trust companies are distinguished from banks in that they offer trust management services to their customers. (However, the management of trust assets is a contractual arrangement between the trustor (or trustee) and the trust company, regulated by contract law, not by the Financial Institutions Act.) Trust companies may also take deposits, and offer other services relating to handling share transactions such as RRSP's, share transfers and public offerings.

Credit Unions can also obtain an authorization allowing them to provide trust services.

Extra-provincial trust companies

A trust company that is incorporated either federally or in another province may register in British Columbia as an extra-provincial trust company. This allows it to have branch offices in this province. The majority of trust companies in British Columbia are extra-provincial trust companies (there are 41 extra-provincial trust companies compared to six incorporated in British Columbia), and most of them are incorporated federally.

Specifically, we examined whether FICOM was verifying that credit unions and trust companies operating in British Columbia were complying with the Financial Institutions Act and, when relevant, with the Credit Union Incorporation Act, and with the associated regulations and policies, with respect to:

- **incorporation and ownership;**
- **business operations (including application for business authorization, maintaining minimum capital and liquidity, annual filing requirements and market conduct);**

- corporate governance (including standards for board membership and investment and lending policies);
- related party transactions; and
- coverage by the relevant deposit insurance organizations.

As well, we examined whether FICOM was carrying out examinations with the frequency required in the Act, and taking enforcement action when necessary.

Our audit was conducted in accordance with the assurance standards recommended by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

Our audit was concerned only with those sections of the Act that require FICOM to impose a duty on credit unions or trust companies. Accordingly, we excluded from our audit the sections of the Act dealing with the operation and administration of the Credit Union Deposit Insurance Corporation of British Columbia and with the organization of FICOM.

In addition, we did not examine the regulation of insurance companies under the Financial Institutions Act because the nature of these companies is different from credit unions and trust companies. We also did not assess the adequacy of the various legislative requirements.

We examined FICOM's monitoring work, activities and processes for a sample we drew from the entire population of credit unions and trust companies as of September 1999. The sample included 16 of the 79 credit unions and all 6 trust companies incorporated in British Columbia, as well as 10 of the 41 extra-provincial trust companies operating in the province.

As well as the six trust companies incorporated in British Columbia, we also included in our audit Four Corners Community Savings, which is a Crown corporation (the B.C. Community Financial Services Corporation) established by the Community Financial Services Act. Under that Act, the Financial Institutions Act applies to the corporation as if it were a trust company. It is monitored by FICOM, and was therefore included in the scope of our audit.

Overall Conclusion

In our opinion, the Financial Institutions Commission was doing adequate monitoring work to verify that credit unions and trust companies were complying with the Financial Institutions Act and the Credit Union Incorporation Act, in all significant respects, during the 1999 calendar year; except for monitoring compliance with the market conduct sections of the Financial Institutions Act by extra-provincial trust companies, where FICOM's work is limited to dealing with complaints.

Key Findings

For the purposes of our audit, we divided the requirements of the Financial Institutions Act and the Credit Union Incorporation Act into five parts: incorporation and ownership; business operations; corporate governance; related party transactions; and coverage by the relevant deposit insurance organizations. These five parts are described more fully in the next section.

The sections of the Financial Institutions Act relating to business operations and deposit insurance also apply to trust companies incorporated outside of British Columbia. This is described in more detail later in the report, in the section on extra-provincial trust companies.

Our findings relate to the 1999 calendar year.

Incorporation and ownership

We found that FICOM was verifying that the requirements of the legislation, as they apply to incorporation (credit unions and trust companies), and concentration of share ownership (trust companies), were being complied with.

Business operations

We found that FICOM was monitoring to determine whether:

- Business authorizations were only issued to those credit unions and trust companies that met the prescribed requirements.
- Credit unions and trust companies incorporated in British Columbia were maintaining the minimum liquidity and capital base as prescribed by legislation. However, we also found that while FICOM was reviewing the liquidity reported by extra-provincial trust companies, the legislation did not define minimum liquidity for extra-provincial trust companies in such a way that allows it to be measured.

- The annual filing requirements were complied with.
- The market conduct requirements of the Act were complied with by credit unions and trust companies incorporated in British Columbia. However, we also found that FICOM monitored the market conduct of extra-provincial trust companies only by responding to complaints.

Corporate governance

We found that FICOM was checking that officials and board members filed their personal information returns. However, we found that FICOM was not making criminal record checks in foreign jurisdictions, and was not making bankruptcy checks unless the official or board member disclosed a previous bankruptcy.

As well, we found that FICOM was checking that credit unions' and trust companies' investment and lending policies were appropriate, and that the institutions complied with them.

Related Party Transactions

We found that FICOM was checking that trust companies and credit unions engage only in those related party transactions allowed by the Act or consented to by FICOM, and approved by the board's Conduct Review Committee.

Coverage by the relevant deposit insurance organizations

We found that FICOM was ensuring that credit unions and trust companies incorporated in British Columbia had deposit insurance as required. And while we found that FICOM does not verify the deposit insurance of extra-provincial trust companies on an ongoing basis, we were able to satisfy ourselves that these companies were covered.

Frequency of examinations

We found that FICOM was performing annual examinations as often as is required by the Act.

Enforcement action

We found that FICOM was taking enforcement action when instances of non-compliance were noted.

Reliance on the primary regulator of extra-provincial trust companies

We found that FICOM has no formal agreement with federal Office of the Superintendent of Financial Institutions.



summary of recommendations

Although we have concluded that the Financial Institutions Commission was doing sufficient monitoring work to verify that credit unions and trust companies were complying with the Acts and regulations in all significant respects, except for the monitoring of extra-provincial trust companies for compliance with the market conduct sections of the Act, we have also made some recommendations to management.

These recommendations are listed below for ease of reference. They should be regarded in the context of the full report.

We recommend that the Financial Institutions Commission:

- 1 remind credit unions of the requirement to submit changes in directors and senior officers on a timely basis.***
- 2 (a & b) extend its background checks to include any foreign countries that directors and senior officers have been residents of in the past five years.***
- 3 (a & b) perform bankruptcy checks on all directors and officers.***
- 4 seek assurance from the Corporate Registry that the annual filings of credit unions and trust companies are up to date.***
- 5 liaise with the Registrar of Companies to ensure that future credit union and trust company incorporations are properly gazetted.***
- 6 develop and formally adopt an internal policy clarifying how it will verify that extra-provincial trust companies maintain “sufficient liquid assets.”***
- 7 periodically perform field examinations of extra-provincial trust companies to obtain assurance that the marketing requirements of the Financial Institutions Act are being complied with. Alternatively, FICOM should seek assurance from the primary regulator that British Columbia’s legislated requirements are being complied with.***

- 8 verify annually that extra-provincial deposit-taking trust companies operating in British Columbia are members of CDIC.**
- 9 enter into an agreement with OSFI to share information about trust companies operating in British Columbia that are regulated by OSFI.**



detailed report



how FICOM discharges its regulatory responsibilities

Incorporation and ownership

Any credit union or trust company wishing to incorporate in British Columbia must complete an application for incorporation and file the completed form with FICOM. A credit union must also provide to FICOM its constitution and rules (prepared in accordance with the act) and a business plan. A trust company must provide its memorandum and articles (prepared in accordance with the act) and a business plan.

FICOM must be satisfied that:

- the activities set out in the business plan are appropriate to the type of business the credit union or trust company intends to carry on;
- each of the proposed first directors and senior officers have completed and submitted the required personal information return; and
- the credit union or trust company can obtain a business authorization (see below) within a reasonable time after the incorporation.

FICOM reviews the information provided to it, has discussions with the applicants and requests any additional information needed. Once the commissioners are satisfied with the application, they recommend to the Minister of Finance that consent be given for the incorporation. With the Minister's consent, the incorporation documents are forwarded to the Registrar of Companies, who completes the incorporation process.

A credit union's rules (prepared in accordance with the Credit Union Incorporation Act) limit the number of shares that a member can own. In the case of trust companies, it is the Financial Institutions Act that limits share ownership, by requiring FICOM to approve any concentration of ownership over 10%. FICOM gets assurance that these rules are complied with during its regular examinations of the credit unions' and trust companies' books and records.

None of these requirements apply to extra-provincial corporations, as discussed later in the section "Extra-provincial trust companies."

Business operations

The requirements for business operations described below apply, with some modifications, to extra-provincial trust companies as well as to credit unions and trust companies.

Business authorization

A business authorization is a certificate issued by FICOM permitting a credit union or trust company to do business in British Columbia. The authorization specifies the type of business that can be carried on (usually deposit-taking, trust business, or both), and may include any limitations that FICOM considers appropriate.

A credit union or trust company must apply for a business authorization within one year of being incorporated. The application must include sufficient detail to convince FICOM that the organization will be a viable business. Therefore, the plan of operations must detail the proposed market strategy, products to be offered, and projected revenues, expenses and capital. The plan must also include branch locations, time lines, an organization chart including the name of the General Manager, and the systems to be used for processing the data (such as banking applications, payroll, word processing and reporting.) As well, an “Investment and Lending Policy” that meets with FICOM’s concurrence, together with other operational policies and procedures, must be developed and adopted.

In addition to providing its operational plans, the credit union or trust company must show evidence of having raised sufficient start-up capital. And, as a final part of the business authorization process, a credit union must obtain membership in the Credit Union Central of British Columbia and the Stabilization Central Credit Union (these organizations are described in the appendices); while a trust company, if it is applying to do deposit business, must obtain membership in the Canada Deposit Insurance Corporation (as described later) and the Canadian Payments Association.

If, after reviewing all this information and interviewing the proponents, FICOM is satisfied that the business has the necessary staff, structure and financing in place taking into account the expected volume of its business, a business authorization certificate is issued. A copy of the business authorization is required to be filed with the registrar of companies.

The Canadian Payments Association

Clearing and settlement in Canada is handled through the Canadian Payments Association (CPA). Canada's payments system consists of a set of separate networks that include the cheque payments system, the credit card systems of VISA and MasterCard, the automatic teller machine (ATM), point-of-sale (POS) terminal and debit card systems of Interac, and the respective clearing systems for debt and equity instruments and for mutual funds.

Membership in the CPA is presently limited to federally and provincially regulated deposit-taking institutions, of which there are two categories: Direct and Indirect clearers. Direct clearers maintain settlement accounts at the Bank of Canada. They clear and settle their own payments directly through the Automated Clearing Settlement System (ACSS) and, in turn, provide clearing services and access to settlement facilities for indirect clearers. To be eligible to act as a direct clearer, an institution must account for a minimum of 0.5 per cent of the total national clearing volume. Of the approximately 132 members of the CPA, only 13 are direct clearers: the Bank of Canada, eight banks, one trust company, two group clearers (which clear on behalf of the credit unions and caisses populaires) and one provincial government savings institution.

While CPA membership is restricted to deposit-taking institutions, there are mechanisms through which non-deposit-taking institutions may gain more limited forms of payments system access. Several hundred institutions provide chequing facilities for their customers and obtain indirect access to the cheque clearing mechanisms by means of commercially negotiated agency agreements with one of the members.

.....
Source: Canadian Payments Association

Maintaining capital and liquidity

The Financial Institutions Act requires credit unions and trust companies to maintain sufficient capital and liquidity (defined in the Act and regulation) at all times.

Capital is the difference between what a company owns and what it owes, and sufficient capital allows it to carry on business through any downturns in the economy or in the event of adverse business impacts. For credit unions and trust companies, capital is made up of the paid-up shares, contributed surplus and retained earnings, less any investments in other corporations (where permitted) that are also required to have a minimum capital.

The Capital Requirements Regulation sets out a weighting formula that is to be applied to specific assets of the credit union or trust company. The minimum capital required is set at 6% of the weighted total for credit unions, and 8% of the weighted total for trust companies. An additional requirement for a trust company is that its capital always be more than \$5 million (unless the trust company is not deposit-taking, in which case its minimum capital must be equal to 0.5% of the total trust assets under its administration).

“Liquidity” is a measure of a company’s ability to meet its payment obligations on an ongoing basis. In general, institutions try to match maturing liabilities with maturing assets in order to have sufficient cash on hand to pay out liabilities as they come due.

“Sufficient liquidity” is also set out in the regulation:

- A credit union must have an amount on deposit with Credit Union Central of British Columbia that is equal to or greater than 10% of its liabilities for deposits and debt instruments. If 10% of a credit union’s liabilities for deposits and debt instruments is more than 1.5% of total credit union assets in British Columbia, it must have an amount equal to 1.5% of total credit union assets in British Columbia deposited in Credit Union Central of British Columbia with the remainder of the 10% liquidity requirement made up of prescribed liquid assets held by the credit union itself.
- A trust company has sufficient liquidity if its cash—and any assets that can be turned into cash within a 100 days—is at least equal to 10% of its liabilities for deposits and debts.
- A trust company that does not take deposits is exempted from the requirement to maintain sufficient liquidity. (It need only meet the minimum capital requirement.)

FICOM monitors capital and liquidity by analysing monthly returns from credit unions (provided through the Stabilization Central Credit Union). Trust companies in British Columbia need only file quarterly returns, since none of those incorporated in the province are deposit-taking. The correct completion of these returns is monitored by an annual examination of the credit union and trust company books and records, carried out by FICOM staff.

Failure to maintain minimum capital and liquidity levels results in either informal or formal action by FICOM, usually requiring the company to rectify the deficiency. FICOM also has the authority to set higher capital and liquidity levels above what is required by regulation.

In addition, a credit union or trust company is prohibited under the Act from lending money or guaranteeing loans when it is not in compliance with the liquidity requirements.

Annual filing requirements

Credit unions and trust companies are required to submit audited financial statements and other information to FICOM within 90 days of their year-end.

For credit unions, the “other information” is prescribed in the regulations and consists of more detailed financial information than would be available from their audited financial statements.

For trust companies, the other information required is a copy of the “Annual Statement of Trust Companies” as prepared and published by the federal Office of the Superintendent of Financial Institutions. This statement is mainly financial, but also includes information about the company, such as the names of directors and officers.

FICOM monitors the submissions to get assurance they are complete and received on a timely basis. It uses the information to verify the capital and liquidity data contained in the monthly and quarterly unaudited reports it receives from the credit unions and trust companies, and to assess the financial health of the organizations.

Deposits

The Financial Institutions Act requires that credit unions accept deposits only from depositors specified in the Act. Essentially, this means that a Credit Union must only accept deposits from its members. No similar restriction is placed on a trust company.

FICOM monitors this requirement as part of its annual examination of credit union books and records.

Marketing of financial products

The Financial Institutions Act requires that credit unions and trust companies clearly identify themselves in all communications, such as forms, correspondence and advertisements.

It is also the credit unions’ and trust companies’ responsibility to communicate the rules surrounding deposit insurance guarantees clearly and accurately. A credit union or trust company must not use the word “guarantee” unless the investment or deposit is in fact guaranteed by:

- the Credit Union Deposit Insurance Corporation (for credit unions) or the Canada Deposit Insurance Corporation (for trust companies);
- Canada or a province; or
- someone who has been approved by FICOM and who deals at arms length with all parties involved in the transaction, and whose identity has been disclosed to the investor/depositor.

FICOM monitors this requirement as part of its annual examination of credit union and trust company books and records. During the examination, FICOM reviews application forms, contracts and other correspondence to obtain assurance that credit unions and trust companies have properly identified themselves in their dealings with customers. It also reviews how “guarantee” has been used in advertising, pamphlets and other correspondence, and verifies that where the word occurs, it is used appropriately. Both deposit insurance corporations have published pamphlets describing approved wording for advertising and information given to the public. If this information or other correspondence does not conform to that wording, FICOM has the credit union or trust company remove the information from circulation.

The Financial Institutions Act also prohibits “tied selling”—that is, the selling of a product or service to customers only if they also purchase another product or service. An example of tied selling could be where a package of products is marketed together, with the institution refusing to sell any of the products individually. However, preferential interest rates given to customers who purchase several products and services is not considered to be a form of tied selling, and neither is the requirement for a customer to maintain an account to facilitate the making or receiving of scheduled payments. During the annual examination, FICOM reviews contracts and offerings to verify that products have not been, and are not required to be, sold together.

Under the Financial Institutions Act, customer information cannot be collected for one purpose and then used for another without customer consent. For example, credit unions and trust companies cannot collect information for a loan or mortgage and then provide that information to an insurance subsidiary, unless the consumer knowingly consents to the disclosure.

FICOM reviews forms, contracts and company policies at the annual examination, but relies mainly on customer complaints to monitor this requirement.

Public access to audited financial statements

Credit unions and trust companies are required by the Act to allow members of the public to review their audited financial statements, at any branch during regular business hours. The credit union or trust company is permitted to charge a fee for providing a copy of the audited financial statements, if one is requested.

FICOM monitors this requirement during its annual examination, by reviewing information made available to the public in pamphlets and by asking questions of staff.

Corporate governance

The following requirements for corporate governance apply to credit unions and British Columbia trust companies, but not to extra-provincial trust companies. There are some exceptions, which are described in the section on extra-provincial trust companies later in this report.

Standards for directors and senior officers

The Financial Institutions Act gives FICOM the authority to disqualify someone from being a director or senior officer of a credit union or trust company, if FICOM believes that the person has a conflict of interest or is someone “who ought not to be in a position to control or influence” a credit union or trust company.

In addition, persons prohibited from acting as directors or officers under the Company Act are also precluded from being directors or officers of credit unions or trust companies. This includes persons convicted of fraud within the past five years and undischarged bankrupts.

Accordingly, the Act requires that board members and officers submit personal information returns to FICOM. The information requested is prescribed in the regulations, and includes details about employment, memberships in professional organizations, directorships, shareholdings of more than 10% of a company, any criminal code conviction, any civil judgement or disciplinary action taken by a professional organizations or self-regulating body, and any bankruptcy.

The legislation states that a Director or officer must submit a personal information return prior to commencing duties, but does not require FICOM to approve of them before they commence their duties. Initially, FICOM performs just a cursory review of the returns it receives. Once this review is performed, FICOM sends a letter acknowledging receipt of the return and advising the person that they may assume their duties. FICOM then performs criminal record checks and other checks as necessary. If these checks prove unsatisfactory, FICOM may order that a person resign from the board or their position in the company.

At its annual examination, FICOM checks to see that it has a complete and up to date list of the directors and officers, and that they all submitted a personal information return.

Investment and lending policies

Investments and lending, by their very nature, are subject to the risk of loss. To mitigate this risk, the Financial Institutions Act requires that credit unions and trust companies have prudent investment and lending policies.

The board of a credit union or trust company is required to create an Investment and Lending Committee, which must develop investment and lending policies and submit them to FICOM. The process requires FICOM to concur with the policies.

A model investment and lending policy has been developed by FICOM and the Credit Union Central of British Columbia (CUCBC) to facilitate the development of policies required under the Act. Credit unions and trust companies can, nevertheless, have investment and lending policies that differ from the model, provided FICOM concurs with them. FICOM continually monitors these policies and, as new issues or deficiencies are identified, it and CUCBC develop revisions to the model. However, the Financial Institutions Act requires that the board of directors of each credit union and trust company review and approve their policies on an annual basis and assess the need for revisions applicable to their institutions.

Trust companies that are not deposit-taking are required to have prudent investment and lending policies, but are not required to submit their policies to FICOM.

The main reason for these policies is to ensure that financial institutions have structures in place to manage the decisions and risks in their investment and loan activities. For example, the policies serve to prevent concentrations of investments or loans in any one area or with any one person or group. In this way, the loss from an investment or loan with an individual customer is less likely to have a serious effect on the credit union or trust company.

FICOM monitors a credit union's adherence to its investment and loan policies during its annual examination. In reviewing the investment policy, FICOM assesses the percentage ownership of specific assets (such as land) and other restricted investments. To test the loan policies, a sample of both commercial (if applicable) and personal loans are taken at the time of the annual examination and evaluated against the credit union's investment and loan policy. Any exceptions are

noted in the annual examination report. This is a critical part of the examination, because it covers such areas as the risk rating on the loan portfolio, the lending limits of the credit union employees, the appropriateness of the collateral for the loan, and the ability of the customer to repay the loan.

FICOM also reviews the investment and lending policies during the annual examination to verify that they are up to date and appropriate for the current business environment, and that any changes have been properly approved.

Related party transactions

In general terms, a related party is someone who is able to exert influence over the directors or officers of a credit union or trust company, and who can thus influence financial or operational decisions, force certain transactions to occur, or restrict the board or management from carrying out a particular activity. Related parties include current and past employees, directors and senior officers, directors and officers of affiliated companies, spouses and certain other relatives, the auditors and the audit firm's partners, and corporations controlled by related parties.

Credit unions and trust companies are allowed to pay salaries, fees and pension benefits to their related parties, as well as to provide them the same services and products as are offered to their regular customers, as long as those services and products are at not less than fair market value. However, there are restrictions on loans and mortgages to related parties.

The Financial Institutions Act places restrictions on other transactions between credit unions and trust companies and their related parties, from requiring them to be reviewed and approved by the Conduct Review Committee of the board of directors, to requiring them to be approved by FICOM or banning them altogether.

Identifying related parties can be difficult, especially where an extensive range of relationships is involved. Identifying related party transactions can also be difficult since, by definition, they are not at arm's length. For these reasons, credit unions and trust companies are required to keep a current listing of their related parties. As well as the persons described above as related parties, FICOM can designate additional people to be related parties of the credit union or trust company.

FICOM monitors these requirements as part of the annual examinations it performs.

Coverage by the relevant deposit insurance organizations

Deposit insurance coverage for deposits at credit unions is provided by the Credit Union Deposit Insurance Corporation of British Columbia (CUDIC). CUDIC manages a compensation fund from which payments can be made to qualified depositors who have lost money through the failure of a credit union. Annual payments into the fund are made by credit unions, based on a percentage of their assets (this is described in more detail in the appendices).

FICOM does not monitor the insurance coverage of credit unions since a credit union is automatically covered by CUDIC as long as it has a business authorization. Therefore, FICOM's monitoring activities are directed towards ensuring that a credit union can continue to hold a business authorization.

Details of the deposit insurance coverage available to credit union depositors are provided in the section on detailed findings related to credit unions.

Trust companies that carry on deposit business, both those incorporated in British Columbia and the extra-provincial trust companies, must be members of a qualified insurance plan. The Act specifies that this plan should be that of the Canada Deposit Insurance Corporation (CDIC)—a federally incorporated and regulated corporation—or another plan designated by the Lieutenant-Governor in Council. To date, since no other plan has been designated, all trust companies operating in British Columbia that take deposits must therefore be members of the CDIC.

When a trust company applies for a business authorization that will allow it to take deposits, FICOM checks that it is a member of CDIC. Thereafter, FICOM relies on CDIC to notify it if a trust company's membership is being withdrawn.

Details of the deposit insurance coverage available to trust company depositors are provided in the sections on detailed findings related to trust companies and extra-provincial trust companies.

It is not the purpose of the Financial Institutions Act to ensure that the deposits and investments of every credit union and trust company customer are insured. Many investments available from credit unions and trust companies, such as those shown in Exhibit 3, are not insured. What the Act does do is require credit unions and trust companies to make clear, in their dealings with customers, which types of deposits and investments are insured and which are not, so that the customer can make informed decisions.

Exhibit 3

Examples of investments that are not insured by the Credit Union Deposit Insurance Corporation or the Canada Deposit Insurance Corporation

Some types of deposits and investments available from credit unions and trust companies are not insured. The most common types include:

- debentures issued by banks;
- bonds and debentures issued by governments and corporations;
- treasury bills;
- mutual funds;
- stocks; and
- investments in mortgages.

Foreign currency deposits (e.g., US dollar accounts), and term deposits that mature more than five years after the deposit date, are covered by credit union insurance, but not by trust company insurance.

Source: Compiled by the Office of the Auditor General from CDIC and CUDIC documents

Carrying out examinations with the frequency required in the Act

FICOM is legally required to conduct, at least annually, an examination of the condition and affairs of each credit union and trust company incorporated in British Columbia.

The examination must cover: the credit union's or trust company's condition and ability to meet its obligations when they become due; the adequacy of the credit union's or trust company's business and financial practices, and of its management procedures and standards; and the extent of the credit union's or trust company's compliance with orders made or consents given by FICOM, and with the conditions of its business authorization.

At the end of each examination, a report is issued, discussed with management and sent to the credit union's or trust company's board of directors. Depending on the findings, management and the board are required to take action to remedy deficiencies or rectify instances of non-compliance discovered by the examination. The board has to respond to FICOM with the actions it intends to take to address the concerns raised in the report.

Extra-provincial trust companies are regulated either by OSFI or by the regulator in their province of incorporation. Accordingly, FICOM is not required to, and does not, conduct examinations of extra-provincial trust companies, although the Act gives it the authority to do so if it wishes.

Taking enforcement action when necessary

The need for enforcement action can arise from the review of the monthly and quarterly financial returns, from the findings of an examination (especially if the findings indicate that a problem reported at a previous examination has not been rectified) or from a specific matter that comes to FICOM's attention in some other fashion.

FICOM's approach to enforcement is a graduated one. The first step is to discuss with management or the board the concerns that have arisen, and to suggest ways that the credit union or trust company can deal with them.

If the results of these discussions are unsatisfactory, or if the attempts to rectify the concerns are ineffectual, FICOM has a number of options:

- It can issue an order under the Financial Institutions Act, requiring an action to be taken or some activity to be stopped. This would usually be done if the concern can be remedied by a particular course of action. Before an order is made, a credit union or trust company will often be given the opportunity to enter into a voluntary compliance agreement. Such an agreement has the same effect as an order, but allows the credit union or trust company to take the initiative in solving its problems.
- It can, in the case of a credit union, exercise regulatory intervention under the Financial Institutions Act by placing the credit union under supervision. While the credit union is under supervision, FICOM may appoint an administrator to act in place of the directors and senior officers. The period of supervision may last until the credit union is deemed capable of carrying on operations in compliance with the Act.
- It can revoke the business authorization of a credit union or trust company, which must then cease doing deposit and/or trust business.

However, the best approach to enforcement is to identify potential problems and deal with them before enforcement becomes necessary. Accordingly, FICOM maintains informal contact with the credit unions and trust companies before formal action is needed. As well, in the case of credit unions, the Stabilization Central Credit Union (SCCU) has a significant role to play in these "preventative measures."

The monthly financial returns of credit unions come to FICOM via SCCU, which also reviews them. Credit unions that show weakness or deteriorating trends in their financial

indicators (but no cause for intervention) are put on “closely monitored” status. These credit unions are closely monitored and assessed monthly and the need for more SCCU involvement (described below) is determined. From time to time, SCCU will contact credit union management for information or clarification on current financial performance. But, at this stage, no formal notification is given to the credit union.

Stabilization services are available to a credit union whose financial indicators are poor. These services can be requested by the credit union itself, initiated by SCCU or recommended by FICOM. The intent is to assist the credit union out of its financial difficulties. A letter of agreement is signed between the credit union and SCCU, and may be revoked by either party. Under the agreement, SCCU provides management assistance, participates in board meetings, and may require the credit union to engage outside resources or assistance. SCCU gives periodic assessments to the credit union’s board and keeps FICOM informed of all progress.

If FICOM is concerned with the financial performance or business practices of a credit union and believes that more assistance beyond stabilization services is required, it will designate a credit union as being “on the watch list” (OWL). SCCU works with such a credit union to develop a formal plan to address the areas of concern and a timetable for remedial action. SCCU attends to the affairs of the credit union once per month by meeting with management and the board of directors to discuss its progress. A formal monthly meeting is held with FICOM to report each credit union’s progress and SCCU’s assessment. Removal of a credit union from the watch list depends on the successful resolution of the underlying problems and a satisfactory examination report from FICOM.

If these attempts to stabilize the credit union’s situation fail, then supervision can be ordered. As noted above, “supervision” is a formal regulatory designation. It can be requested by a credit union or imposed on it by order from FICOM. A credit union is put under supervision if:

- it needs financial assistance;
- it has contravened its regulatory compliance by not having adequate capital or liquidity;
- it is not complying with its investment and lending policy;
- it is conducting its affairs in a manner that is considered harmful to the institution or its depositors; or
- it may be a risk to the deposit insurance fund.

Normally, once supervision is ordered, SCCU is given the responsibility to direct the credit union. An administrator can be appointed with powers to terminate the duties of the credit union's directors and officers. A formal "Terms of Supervision" agreement is entered into with the credit union, spelling out the terms and conditions of the supervision arrangement and involving SCCU in the control of critical aspects of the credit union's operations. SCCU conducts an initial assessment and, in conjunction with the credit union, develops a plan of action to address the issues. SCCU provides FICOM with monthly and annual written progress reports. The annual report not only reviews the credit union's performance for the period, but also sets out the current year's plan, a budget and the anticipated time of release from supervision.



detailed findings

Credit unions

As of September 1999, there were 79 credit unions operating in British Columbia. Credit unions are financial cooperatives, owned and controlled by the people who use their services.

Incorporation

The Credit Union Incorporation Act, rather than Financial Institutions Act, governs the incorporation process for credit unions. Since the Act came into force in 1990, however, only two credit unions have applied for incorporation.

We found that FICOM had assessed both those applications to verify that they conformed to the requirements of the Act before recommending that the Minister consent to the incorporations. We reviewed the incorporation documents and correspondence files and found that all the required information had been received.

Business operations

Business Authorizations

As well as being incorporated, a credit union must also obtain a business authorization. Application for that authorization must be made within one year of the credit union being incorporated.

We found that FICOM had reviewed the applications it had received, and had documented the reasons for its decisions concerning the issuing of a business authorization.

Maintaining capital and liquidity

On a monthly basis, FICOM uses a number of financial and statistical reports to verify that credit unions are meeting the minimum capital and liquidity requirements outlined in the Act and regulations. These reports are submitted through the Stabilization Central Credit Union (SCCU). Additionally, FICOM prepares a monthly Risk Scoring Report (see Exhibit 4) from the information submitted to SCCU and uses this report for various monitoring purposes. During the annual examination, FICOM verifies that the reports agree with the credit union's records.

Exhibit 4

Risk Scoring Report System

FICOM employs the Risk Scoring Report (RSR) system to help monitor the performance of individual British Columbia credit unions and the industry as a whole. This report is prepared monthly, based on the monthly and other periodic financial and statistical data submitted by the credit unions and on the results of field examinations performed by FICOM staff.

The RSR system, fashioned after an American system referred to as CAMELS, takes into consideration certain financial, managerial and compliance factors that are common to all credit unions. Using the system, FICOM tries to ensure that all credit unions are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on those credit unions showing financial and operational weaknesses or trends.

Under the RSR system, each credit union is assigned a composite rating based on an evaluation and rating of six essential components of a credit union's financial condition and operations. These components address the adequacy of Capital, the quality of Assets, the capability of Management, the quality and level of Earnings, the adequacy of Liquidity, and the Sensitivity to market risk (therefore, CAMELS). Evaluations of the components take into consideration the institution's size and sophistication, the nature and complexity of its activities, and its risk profile.

Composite and component ratings are assigned on a 1 to 5 numerical scale. A 1 indicates the highest rating, for strongest performance and risk management practices and least degree of supervisory concern. A 5 indicates the lowest rating, for weakest performance, inadequate risk management practices and highest degree of supervisory concern.

Source: Compiled by the Office of the Auditor General

We found that FICOM had reviewed the monthly reports to verify that they were received on time and that the credit unions met the minimum capital and liquidity required under the Act and regulations. We also found that FICOM had verified the completeness and accuracy of these monthly reports as part of its field examinations. For the sample that we looked at, FICOM had found that the returns were completed correctly.

We reviewed the Risk Scoring Report and the Summary Trend Analysis Report (prepared from the Risk Scoring Report) to verify that the sample of credit unions had maintained the minimum capital and liquidity requirements for each month. We found that, for our sample credit unions, only one credit union had not met the capital adequacy ratio during the period of review. This credit union had been “on the watch list” and FICOM had been monitoring it closely until the deficiency was resolved.

The calculation of the information on capital and liquidity in the Risk Scoring Report is done automatically by a spreadsheet program. We verified that the formulae and the program gave the correct result.

Annual filing requirements

The annual returns from credit unions are due within 90 days of their year end. We found that FICOM was checking that all credit unions had filed their returns within 90 days, and that the returns were reviewed to verify that all the required information was included. During the period of our audit, no credit union failed to file on time, or to include all the required information.

FICOM prepares a “Year-End Filing Review” worksheet which compares the December 31 Capital Adequacy Return information with the Audited Financial and Statistical Return information. The review is a reasonableness check, not a reconciliation. Vouching for accuracy and completeness of data reported in the returns is the job of the examiners as part of the field examination. Unless differences are significant, they do not follow up on them.

We reviewed the files for evidence that the examiners had verified the information. We also reviewed year-end filings for the credit unions in our sample. All of them, we found, included a Year-End Filing Review worksheet, and the audited information agreed in all significant respects to that used in the year-end ratios to evaluate the credit union.

Deposits

Credit unions may only accept deposits from depositors specified in the Act. Essentially, the Act permits a Credit Union to accept deposits only from its members.

We found that FICOM examiners had reviewed the credit union’s board minutes at the time of the annual examination to verify that the board approved new depositors as members.

Marketing of financial products

We found that during its annual field examination, FICOM had reviewed the application forms, contracts and other correspondence of credit unions to verify that the credit union had properly identified themselves in their dealings with consumers.

While FICOM relies mainly on complaints to determine if there is any tied selling or instances where confidentiality of customer information has not been maintained, we found that the examiners were aware of the prohibition on breaking confidentiality and tied selling, and were diligent in bringing forward any problems they found to their examination report.

The complaints we saw in the files dealt mostly with situations in which the sale of insurance had been targeted at particular customers using their deposit, loan or investment information, or had been tied to the provision of some other service.

We found that FICOM had also reviewed advertising, pamphlets and other correspondence for the use of the word “guarantee,” and had verified that it was used in accordance with the Act, regulations and the Credit Union Deposit Insurance Corporation publications.

In the sample we looked at, no credit unions had been found by FICOM to be in non-compliance. A few instances of non-compliance in previous years had occurred where a credit union’s advertising did not conform to CUDIC’s approved wording. FICOM had required the credit union to remove the information from circulation and correct the inconsistencies.

Public access to financial statements

We found that FICOM is carrying out the necessary procedures at the annual examination to determine whether or not the public is being given access to the credit union’s financial statements. In the sample of examination files we looked at, FICOM had not detected any instances where access to the financial statements was not provided.

The Act also requires credit unions to send their financial statements to their members. That financial information may be condensed, consisting of a statement of profit and loss and a balance sheet, as long as the members are notified that the full audited financial statements are still available on request. We found that, during the annual examination, FICOM checked to verify that this condensed information is complete and accurate.

Corporate governance

Standards for directors and senior officers

FICOM’s database of directors and officers is derived from the personal information returns submitted to it during the year. In the sample we audited, we found that FICOM had verified the database during the annual examination, by reviewing company records to determine whether the database was up to date. We also found that FICOM examiners had checked that all of the directors and officers had submitted personal information returns, and that any resignations recorded in the board minutes had been reported to FICOM.

For a sample of credit unions, we reviewed the personal information returns, FICOM's database and examination files to verify that the returns were being submitted by all directors and officers, and on a timely basis. We found that the returns were submitted by all new directors and officers. However, we found that in some cases, FICOM's database was not updated until the annual examination, and also that some directors and officers had not submitted their returns until after commencing their duties. However, given that FICOM can order the removal of directors and officers after the fact—and that all directors and officers eventually file their returns—we were satisfied that the annual examination would reveal and rectify any non-compliance.

To determine if resignations were being reported to FICOM, we reviewed the records filed with the Registrar of Companies and compared it to the FICOM's database. We found that resignations had not always been promptly conveyed to FICOM.

Recommendation 1

We recommend that FICOM remind credit unions of the requirement to submit changes in directors and senior officers on a timely basis.

The Financial Institutions Act requires institutions to notify FICOM of changes in directors. As well, under the Company Act, credit unions must notify the Registrar of Companies of any resignation or removal of a director (except for those re-elected or reappointed the same day). Such notification, made on a "Notice of Directors" form, must be made within 14 days. In our view, requiring credit unions to send a copy of this form to FICOM as well could be an efficient and timely way to ensure that all changes in directors are captured.

We reviewed the personal information returns and found that FICOM had carried out the required criminal record checks on directors and officers, though not on a timely basis. That problem has since been rectified.

During this same review, we noted that FICOM does not perform criminal record checks in foreign countries when the director or senior officer has recently immigrated to Canada or returned from living abroad. We believe that FICOM should extend the criminal record checks, or some other form of background check, to include foreign countries for directors and senior officers who have not been full-time residents of Canada for the past five years. (Five years would be consistent with FICOM's power to disqualify someone who has been

discharged from bankruptcy within the last five years, as described below.)

Recommendation 2(a)

We recommend that FICOM extend its background checks to include any foreign countries that directors and senior officers have been residents of in the past five years.

The legislation specifically disqualifies “undischarged bankrupts” from acting as directors and officers, and allows FICOM to disqualify those who have been discharged from bankruptcy within the last five years. However, bankruptcy checks are no longer being carried out on all directors and officers (as was done before 1992), unless the individuals indicate on their return that they have been bankrupt. We believe that FICOM should resume full bankruptcy checks.

Recommendation 3(a)

We recommend that FICOM perform bankruptcy checks on all directors and officers.

Legislation also requires that directors and senior officers of credit unions submit their personal information returns before they begin their duties. However, we noted that some credit unions do not distribute the returns to their directors until their first board meeting—which is typically held immediately after the annual general meeting, at which the new directors are elected. Some of these directors may have been nominated from the floor. Thus, in our view, there is no practical way for this requirement to be enforced.

Investment and lending policies

Each credit union’s investment and lending policies must be reviewed annually by its Investment and Loan Committee. In our audit sample, we found that FICOM’s examiners reviewed the minutes of the committee to determine that it had performed its annual review and approved any changes made during the year.

From our review of the minutes and investment and lending policies in the examination files of our sample of credit unions, we also found that FICOM had, as required, received and concurred with the policies and any changes to them.

We also found that, as part of their field examination, FICOM’s examiners review a sample of investments and loans, to confirm that the credit union has followed its own policies.

In addition, the examiners were checking such things as adequacy of security, supporting documentation, and verification of the borrower's information. The exceptions noted were brought to the attention of the board of directors. FICOM followed up on these exceptions during the subsequent annual examination.

Related party transactions

Credit unions are required to keep an up-to-date listing of "related parties" and all their outstanding borrowings. Under the legislation, a person is considered to remain a related party for 12 months after he or she leaves the credit union.

We found that, during its annual examination, FICOM had reviewed the list of related parties kept by the credit unions in our sample, to determine if the lists were complete. We also found that FICOM had looked for transactions with related parties, in particular, looking for loan transactions, to confirm that all were allowed by the Act and had been reviewed by the Conduct Review Committee or approved by FICOM.

When FICOM's examination had noted inadequate procedures or non-compliance with these requirements, we found that it had properly included the problems in the examination report to the particular credit union's management and board of directors.

Coverage by the relevant deposit insurance organization

The Credit Union Deposit Insurance Corporation of British Columbia (CUDIC, see Appendix D) provides deposit insurance for credit unions. FICOM does not need to verify whether a credit union has coverage through CUDIC, since, as long as the credit union has a business authorization, its customers' qualifying deposits are automatically covered (see Exhibit 5).

CUDIC is funded by payments from the credit unions. FICOM assesses the amounts and collects them from the deposits the credit unions maintain with the Credit Union Central of British Columbia (CUCBC; see Appendix D). We verified that, for the sample of credit unions that we looked at, the 1999 assessment and collection of these fees was done accurately.

Exhibit 5

Are your deposits with British Columbia credit unions insured?

The Credit Union Deposit Insurance Corporation (CUDIC), a provincial government corporation, was established in 1958 to protect credit union members against the loss of deposits held by British Columbia credit unions.

All credit unions in the province have deposit insurance coverage through CUDIC.

CUDIC guarantees that money on deposit and money invested in non-equity shares will be repaid up to a maximum of \$100,000 per "separate deposit" in each credit union.

Each of the following is treated as a "separate deposit":

- (a) the aggregate of all deposits that are shown in the records of the credit union as trust accounts and deposited in trust for the benefit of the same beneficiary, whether or not the identity of the beneficiary is disclosed in the records of the credit union.
- (b) the aggregate of all deposits that are shown in the records of the credit union as joint accounts to the credit of the same joint depositors.
- (c) the aggregate of all deposits that are shown in the records of the credit union as registered retirement savings plans under the Income Tax Act (Canada) to the credit of the same depositor.
- (d) the aggregate of all deposits that are shown in the records of the credit union as registered retirement income funds under the Income Tax Act (Canada) to the credit of the same depositor.
- (e) the aggregate of all other deposits not referred to in (a) to (d) above that are credited to the same depositor in the records of the credit union.

For example, the maximum deposit insurance coverage two credit union members will receive by making the insurable deposits shown (money on deposit or money invested in non-equity shares) at the same credit union is as follows:

	<u>Maximum Coverage</u>
Member "A"	
Savings, chequing and term deposits	\$100,000.00
Registered Retirement Savings Plan (RRSPs)	\$100,000.00
Registered Retirement Income Fund (RRIFs)	\$100,000.00
Member "B"	
Savings, chequing and term deposits	\$100,000.00
Registered Retirement Savings Plan (RRSPs)	\$100,000.00
Registered Retirement Income Fund (RRIFs)	\$100,000.00
Members "A" and "B" jointly	
Savings, chequing and term deposits	\$100,000.00

Deposits in different credit unions are insured separately, but deposits in different branches of the same credit union are not insured separately.

Credit union equity shares, and investments such as mutual funds or RRSP equity plans, are not covered by the deposit insurance guarantee.

continued . . .

This information is presented in summary form. It should not be relied upon as a complete explanation of deposit insurance coverage.

Additional information can be obtained by contacting your credit union manager or:

Credit Union Deposit Insurance Corporation
c/o Financial Institutions Commission
Suite 1900
1050 W. Pender Street
Vancouver, BC
V6E 3S7
tel: 604-660-2947

Source: Compiled by the Office of the Auditor General from the information obtained from the website of the Credit Union Deposit Insurance Corporation

Carrying out examinations with the frequency required in the Act

The Financial Institutions Act requires FICOM to examine each credit union annually for compliance with the Act.

These examinations take the form of either desk examinations, where FICOM staff request and review information from the credit union, or field examinations, where FICOM staff visit the credit union to examine its files and records. Desk examinations are performed only on those credit unions with a low (i.e. “good”) Risk Scoring Report system rating. Field examinations cover a wider range of topics than the desk examinations, and a credit union that has been given a desk examination will always receive a field examination in the following year.

We found that FICOM had used its standardized examination programs to ensure that the relevant sections of the Act were covered during the examination. We also found that FICOM had reported any adverse findings to management and the board of directors of the credit union.

FICOM interprets the requirement for annual examinations to mean once each fiscal year (the year ending March 31). All of the credit unions in our sample had been examined in each of the previous two fiscal years as well as in the current fiscal year (or were scheduled for examination before the fiscal year end).

Taking enforcement action when necessary

When necessary, FICOM takes enforcement action as a result of the review of the monthly financial returns, or in response to the findings of an examination or a specific matter that comes to FICOM's attention in some other fashion.

The monthly and quarterly returns are reviewed by staff members and the Monitoring Committee of FICOM. We attended a Monitoring Committee meeting in November 1999, and verified that all the credit unions flagged by the Risk Scoring Report system were discussed by the committee.

We looked at the examination reports issued by FICOM to credit unions during the period of our audit and found that the examiners had followed up on all previous years' findings to ensure they were either resolved or brought back to the credit union's management and board for their further consideration.

British Columbia trust companies

At the time of our audit, six trust companies were incorporated in British Columbia. These included one trust company which had recently voluntarily revoked its business authorization, and one inactive trust company.

In our audit, we looked at the files of all these six trust companies, and also the files of Four Corners Community Savings, which is a Crown corporation (the B.C. Community Financial Services Corporation) established by the Community Financial Services Act. Under that Act, certain sections of the Financial Institutions Act apply to the corporation as if it were a trust company. Its compliance with those sections of the Act is monitored by FICOM, and it was therefore included in the scope of our audit.

Certain sections of the Financial Institutions Act, as explained throughout this section, apply only to trust companies which take deposits, and therefore do not apply to the trust companies incorporated in British Columbia. (The trust companies in the province that take deposits are branches of extra-provincial companies, which are discussed later in this report.) However, these sections do apply to Four Corners Community Savings, since it takes deposits, and so these sections apply to it as if it were a trust company.

The management of trust assets is a contractual arrangement between the trustor (or trustee) and the trust company. The Financial Institutions Act does not regulate these arrangements.

Incorporation and ownership

Four Corners Community Savings was established under its own act in 1994, and began operations in 1995. The requirements of the Financial Institutions Act relating to incorporation and ownership do not apply to it.

Incorporation

Only two trust companies have incorporated in British Columbia since 1990. For both of them, we found that FICOM had verified that the applications for incorporation were satisfactory in all significant respects.

Ownership

For trust companies, concentration of ownership is prohibited unless approved by the Minister of Finance. The Financial Institutions Act considers a concentration of ownership to be direct or indirect ownership of 10% or more of all voting shares in the company. Direct or indirect ownership in relation to a person consists of direct ownership of shares, or shares owned by corporations and partnerships controlled by that person. Indirect ownership also includes related parties who live in the same domicile.

FICOM monitors concentration of ownership by reviewing documents and records during its examination. During our audit, we found that FICOM was performing appropriate procedures to identify share ownership.

We noted one instance where a company had undergone a re-organization that involved a change in ownership in excess of 10%. This company contacted FICOM beforehand to ask for approval for the change. That approval was given by the Minister after FICOM's review of the circumstances.

Business operations

Business Authorization

A newly incorporated trust company must apply for a business authorization within one year of incorporation. We found that both of the trust companies that had been incorporated in British Columbia since 1990 had applied within that time period. We also found that FICOM had determined that both applications were properly completed and contained the necessary information. Both companies received their business authorizations.

Companies may apply to FICOM for permission to voluntarily revoke their business authorizations if the owners decide to discontinue operating a trust business in British Columbia. We found that only one company had voluntarily revoked its business authorization in the last 10 years, and the proper procedures had been followed.

Maintaining capital and liquidity

Companies that do not take deposits are not required to comply with the liquidity requirements of the Act. In addition, FICOM only requires such companies to file quarterly returns detailing their capital. This is therefore the case for the five active British Columbia trust companies.

Four Corners Community Savings takes deposits, and so it is required to comply with both the capital and liquidity requirements, and to file monthly returns.

The returns are due by the end of the month following the reporting period. The trust companies file their quarterly returns according to their own fiscal year, not according to the calendar year or government's fiscal year.

We found that some companies did not file on time, especially for the fourth quarter filings, but the delay was not significant for the cases we reviewed.

We found that FICOM was checking the returns to confirm that the companies were maintaining their capital and liquidity as required by the Act. In addition, we found that FICOM was checking the correct computation of the returns.

We noted that FICOM had promptly identified one trust company which was having trouble maintaining its capital, and had acted to ensure that the minimum capital was maintained.

Annual filing requirements

The annual returns of trust companies are due within 90 days of their year-end.

We found that FICOM had checked that all trust companies had filed their returns within 90 days, and that the returns had been reviewed to verify that all the required information was included.

During the period of our audit, no trust company failed to include all the required information. We noted that some did not file on time, but the delay was not significant.

Deposits

There are no specific requirements in the Act relating to whom trust companies can accept deposits from.

Marketing of financial products

The regulations around marketing are generally aimed at deposit-taking institutions that sell products (such as investments and mortgages) to customers. British Columbia trust companies are not deposit-taking institutions and therefore have no products to sell or market.

We found that FICOM reviewed the activities of the British Columbia trust companies to verify that the marketing requirements did not need to be examined.

Four Corners Community Savings does take deposits, and for that company, we found that FICOM completed the appropriate examination steps to gain assurance that the company was complying with all marketing requirements.

Public access to audited financial statements

We found that FICOM is appropriately carrying out procedures at the annual examination to determine whether or not the public is being given access to the trust company's financial statements. Since most British Columbia trust companies do not have store-front operations where the public is likely to come in, access to the financial statements is generally not an issue.

In the examination files we looked at, FICOM had not reported any instances where access to the financial statements was not provided. Our own review of correspondence files did not find any complaints from the public.

Corporate governance

Standards for directors and senior officers

We found that FICOM had reviewed all of the personal information returns submitted to it. We also found that, at the time of its examination, FICOM reviewed company records to determine who the directors and officers are, and checks to confirm that all of them have submitted returns. For the period that we audited, FICOM did not find any directors or officers who had not submitted returns.

As well, although FICOM had performed criminal record checks on all directors and officers, we found in our audit that this check was not being done on a timely basis. The problem has since been addressed.

During this same review, we noted that FICOM does not perform criminal record checks in foreign countries when the director or senior officer has recently immigrated to Canada or returned from living abroad. We believe that FICOM should extend the criminal record checks, or some other form of background check, to include foreign countries for directors and senior officers who have not been full-time residents of Canada for the past five years. (Five years would be consistent with FICOM's power to disqualify someone who has been discharged from bankruptcy within the last five years, as described below.)

Recommendation 2(b)

We recommend that FICOM extend its background checks to include any foreign countries that directors and senior officers have been residents of in the past five years.

The legislation specifically disqualifies “undischarged bankrupts” from acting as directors and officers, and allows FICOM to disqualify those who have been discharged from bankruptcy within the last five years. However, we found that bankruptcy checks are not being carried out unless directors or officers indicate on their return that they have been bankrupt in the past. We believe that FICOM should perform bankruptcy checks on all directors and officers, as it used to do prior to 1992.

Recommendation 3(b)

We recommend that FICOM perform bankruptcy checks on all directors and senior officers.

Legislation also requires that directors and senior officers of trust companies submit their personal information returns before beginning duties. However, we noted that some trust companies do not distribute the returns to their directors until their first board meeting—which is typically held immediately after the annual general meeting, at which the new directors are elected. Some of these directors may have been nominated from the floor. Thus, in our view, there is no practical way for this requirement to be enforced.

A requirement for trust companies is that a third of the directors must be unaffiliated—that is, have no association with the trust company (not be employed by, not hold shares in, and not be related to an employee or shareholder). We found during our review that FICOM verifies this requirement during its annual examination, and that no exceptions had been noted.

Investment and lending policies

The Financial Institutions Act requires that all companies adhere to prudent standards when making investment and lending decisions. However, non-deposit-taking companies are not required to submit their policies to FICOM.

Nevertheless, from our review of the examination files, we found that FICOM had reviewed the policies of all the trust companies during their annual examination to see if they were appropriate, and that the companies were adhering to them.

FICOM found one trust company that had not completely complied with its investment and lending policies. However, the company had made only one very small loan and, although its investments were all with one financial institution, they were in low risk-term deposits.

Related party transactions

We found that, during its annual examination, FICOM had reviewed the list of related parties kept by the trust companies, and had checked that all transactions with these parties were allowed by the Act and had been reviewed as necessary by the Conduct Review Committee of the trust company's board.

FICOM noted one instance where the payment of dividends had not been reviewed and approved by the Conduct Review Committee. This was pointed out to the trust company, and the committee approved the payment retroactively.

Coverage by the relevant deposit insurance organizations

Deposit insurance for deposits with Four Corners Community Savings is provided under the Community Financial Services Act. Under that Act, qualifying deposits in the company are guaranteed by the provincial government up to \$100,000 (see Exhibit 6). No monitoring is required by FICOM.

If any of the private sector trust companies incorporated in British Columbia were to receive authorization to become deposit-taking, they would need to become members of the Canada Deposit Insurance Corporation in order to provide deposit insurance coverage to their customers (see Exhibit 7).

Exhibit 6

Are your deposits with Four Corners Community Savings insured?

Four Corners Community Savings is a provincial government corporation, authorized to carry on deposit business in British Columbia. By provincial statute, the corporation must not operate a branch outside of the inner city of Vancouver.

The provincial government guarantees the repayment of deposits of principal plus interest of qualifying funds, up to a maximum of \$100,000.

Each of the following is treated as a "separate deposit" of qualifying funds, to which the \$100,000 limit applies: the aggregate of all deposits payable in Canada in Canadian dollars that are:

- (a) credited to trust accounts deposited in trust for the benefit of the depositor;
- (b) shown as joint accounts credited to the same joint depositors;
- (c) shown as registered retirement savings plans under the Income Tax Act (Canada) to the credit of the same depositor;
- (d) shown as registered retirement income funds under the Income Tax Act (Canada) to the credit of the same depositor;
- (e) not referred to in (a) to (d) above, and credited to the same depositor.

If the depositor is a public sector pension plan, or an entity prescribed by the Lieutenant Governor in Council, then separate rules and limits apply.

This information is presented in summary form, and has been taken from the Community Financial Services Act (RSBC 1996) and the Community Financial Services Act Deposit Guarantee Regulation. It should not be relied upon as a complete explanation of deposit insurance coverage. Reference should be made to the Act and regulation.

Additional information can be obtained by contacting the corporation manager, or:

c/o Financial Institutions Commission
 Suite 1900
 1050 W. Pender Street
 Vancouver, BC, V6E 3S7
 tel: 604-660-2947

Source: Community Financial Services Act Deposit Guarantee Regulation

Exhibit 7

Are your deposits with trust companies in British Columbia insured?

The Canada Deposit Insurance Corporation (CDIC) is a federal Crown corporation that was created in 1967 to protect the money deposited in CDIC member institutions in case of their failure.

Trust companies that are authorized to carry on a deposit-taking business in British Columbia are required to be members of CDIC.

To be eligible for CDIC deposit insurance protection, monies must be:

- in Canadian currency, payable in Canada;
- repayable on demand or no later than five years from the date of deposit; and
- insurable "deposits" rather than other types of uninsurable investments.

Insurable "deposits" include:

- savings and chequing accounts;
- term deposits, such as Guaranteed Investment Certificates (GICs), and debentures issued by loan companies;
- money orders, drafts, certified drafts and cheques; and
- traveller's cheques issued by member institutions.

Common types of uninsurable investments include:

- foreign currency deposits (for example, accounts in U.S. dollars);
- term deposits that mature more than five years after the date of deposit;
- debentures issued by banks;
- bonds and debentures issued by governments and corporations;
- treasury bills; and
- investments in mortgages, stocks and mutual funds.

Deposits are insured up to a maximum of \$60,000 per depositor, principal plus interest, at each trust company. Deposits are not insured separately at different branch offices of the same trust company.

CDIC provides separate protection for:

- individual deposits;
- joint deposits;
- deposits held in trust;
- deposits held in registered retirement savings plans (RRSPs); and
- deposits held in registered retirement income funds (RRIFs).

This information is presented in summary form, and has been taken from the Canada Deposit Insurance Corporation brochure "Protecting Your Deposits." It should not be relied on as a complete explanation of deposit insurance coverage.

Additional information can be obtained by contacting your trust company manager or:

Canada Deposit Insurance Corporation
50 O'Connor Street, 17th Floor
P.O. Box 2340, Station D
Ottawa, Ontario K1P 5W5
Tel: 1-800-461-CDIC (1-800-461-2342)

Source: Compiled by the Office of the Auditor General from the CDIC brochure and the Financial Institutions Act

Carrying out examinations with the frequency required in the Act

The Financial Institutions Act requires FICOM to examine each trust company annually for compliance with the Act. All such examinations are done through visits to the companies' offices.

We found that FICOM used the standard examination programs developed for credit unions, modified for the different trust company requirements. Where there had been adverse examination findings, we found that FICOM had reported these to management and the board of directors of the trust company.

FICOM interprets the requirement for annual examinations to mean once each fiscal year (the year ending March 31). One of the trust companies is inactive and is therefore not examined. We found that all except two of the other trust companies had been examined annually in each of the previous two fiscal years. The two exceptions were one company that was not examined until the first week of the following fiscal year because of FICOM staffing constraints, and a second company that was already under close scrutiny by FICOM. We do not consider that these are significant exceptions to the requirement for an annual examination.

Taking enforcement action when necessary

During the period covered by our audit we found that matters of concern arising from the annual examination were properly reported by FICOM to the trust companies and followed up at the next examination. We also considered that the action taken by FICOM was appropriate to the seriousness of the concerns.

In the case of a trust company that experienced problems maintaining its required capital, we found that FICOM was closely monitoring the company and had entered into a voluntary compliance agreement with it requiring it to make up its capital deficiency. In the end, at the request of the company, its business authorization was revoked.

Corporate filings of credit unions and British Columbia trust companies

In carrying out our audit procedures, we noted some deficiencies in the way that credit unions and trust companies were filing with the province’s corporate registry. Two credit unions in our sample, for example, had not filed an annual return or “Notice of Directors” for 1998 and 1999 at the corporate registry.

We found that the corporate registry is not monitoring credit unions and trust companies to see if they have made the required filings. Only if the corporate registry must access a credit union or trust company file for another reason (such as to file a resolution submitted by the financial institution) will it check to see if the annual filings are up to date, and follow up if they are not.

Recommendation 4

We recommend that FICOM seek assurance from the Corporate Registry that the annual filings of credit unions and trust companies are up to date.

In two instances, we found that although the incorporations of trust companies had been recorded at the corporate registry, no notice of the incorporation had been published in the British Columbia Gazette—a requirement contained in the Financial Institutions Act. While administering the Act is the responsibility of FICOM, the responsibility of publishing notices in the gazette is the responsibility of the Registrar of Companies.

Recommendation 5

We recommend that FICOM liaise with the Registrar of Companies to ensure that future credit union and trust company incorporations are properly gazetted.

Under the Financial Institutions Act, FICOM is required to send a copy of any new business authorizations, changes to business authorizations and revocations of business authorizations to the corporate registry. We found that one credit union and many of the trust companies did not have a copy of their business authorization on file there, and two credit unions’ business authorizations had not been updated. However, we found that the notice of revocation for the trust company that had voluntarily revoked its authorization was on file at corporate registry, and had also been noted in the gazette.

Since our audit, FICOM has sent copies of all business authorizations to the corporate registry.

Extra-provincial trust companies

Extra-provincial trust companies are trust companies that have obtained a business authorization from FICOM to do business in British Columbia, although they are incorporated in another jurisdiction and licensed, regulated, or in some other way authorized to carry on the business of a trust company in that jurisdiction. Credit unions and banks are specifically excluded from the definition of “extra-provincial trust company,” as are any corporations that are both a subsidiary of a bank and a loan company regulated by the Trust and Loan Company Act (Canada).

Because the extra-provincial trust companies are already being monitored by the jurisdiction in which they are incorporated (their “primary regulator”), not all of the requirements of the Financial Institutions Act apply to them.

Companies which are incorporated federally or in a “designated province” need only comply with the parts of the Act that relate to business operations and coverage by the relevant deposit insurance organization. A designated province is one that the Lieutenant Governor in Council designates for the purposes of the Act. Alberta, Manitoba, Ontario, Quebec and Saskatchewan have been designated.

Companies incorporated in a province that has not been designated, or in a foreign jurisdiction, must comply with some additional requirements of the Act, notably those covering related party transactions and investment and lending policies.

FICOM is empowered to give orders to extra-provincial trust companies, and it may (though it is not required to) carry out examinations of them.

At the time of our audit, all of the 41 extra-provincial trust companies were incorporated either federally or in a designated province. Thirty-three were incorporated federally, five in Quebec, and one each in Ontario, Manitoba and Saskatchewan. (No trust companies incorporated in British Columbia operate in other provinces.)

We performed our audit work on a sample of 10 of these companies, 8 incorporated federally, and 2 incorporated in other provinces.

Business operations

Business authorization

We found that all the extra-provincial trust companies in our sample had been issued with a business authorization in accordance with the Act. Seven of the companies were already operating in British Columbia when the Act came into force on September 15, 1990, and were deemed by the Act to have met the requirements for having an authorization.

The other three obtained their authorization by submitting the required information (proof of incorporation in the jurisdiction of their primary regulator, a business plan, and proof of membership in an insurance plan), which was duly approved by FICOM before the authorization was issued.

Maintaining capital and liquidity

Under the Financial Institutions Act, extra-provincial corporations must maintain sufficient capital and liquidity at all times. FICOM checks the corporations' capital and liquidity by requiring them to file returns of financial information at the end of each quarter (based on the company's own fiscal year), within one month of the quarter-end.

We found that FICOM was checking that the returns were received on time. The majority of returns were received on time, and those that were late were received within two or three weeks. However, two of the quarterly returns from one company in our sample were three months late. There was no written record that FICOM had followed up with the company to obtain the return.

"Sufficient capital" for extra-provincial trust companies is defined as being more than the greater of \$5 million or what the company's primary regulator requires. We found that FICOM had reviewed the returns of the extra-provincial trust companies in our sample and determined that they were in compliance with the Act.

The legislated liquidity requirement is for "sufficient liquid assets," but, unlike credit unions and trust companies incorporated in British Columbia, this is not defined in a way that it can be measured. The Office of the Superintendent of Financial Institutions (OSFI), the federal regulator and the primary regulator for the majority of the extra-provincial trust companies, does not impose a specific minimum liquidity, although it does monitor liquidity on an ongoing basis.

We found that the extra-provincial trust companies are reporting liquidity to FICOM, using the forms required by their primary regulators. However, since “sufficient liquid assets” is not defined, we could not tell whether British Columbia’s legislated requirements were being met. We determined that if the legislated minimum liquidity requirements for trust companies incorporated in British Columbia were applicable to the extra-provincial trust companies, then the latter would be in compliance.

FICOM relies on the primary regulators to inform it if any of the extra-provincial trust companies have liquidity problems. No current problems have been reported. (See below regarding communications with the primary regulator.)

Recommendation 6

We recommend that FICOM develop and formally adopt an internal policy clarifying how it will verify that extra-provincial trust companies maintain “sufficient liquid assets.”

Annual filing requirements

We found that FICOM was monitoring the annual returns of extra-provincial trust companies, to see that the returns were filed within 90 days, and that the returns included all the required information.

During the period of our audit, no trust company failed to include all the required information. We noted that some did not file on time, but the delay was not significant (not more than three weeks).

Marketing of financial products

Extra-provincial trust companies must comply with the sections of the Act that deal with disclosure of identity in transactions and advertising, tied selling and customer confidentiality.

FICOM’s normal procedures for monitoring compliance with these requirements are carried out at the annual examination. For extra-provincial trust companies, however, FICOM is not performing such examinations (and it is not required to). Instead, FICOM is monitoring compliance by investigating complaints.

We also found that the Trust and Loan Company Act (Canada), under which the majority of extra-provincial trust companies are regulated, does not address market conduct.

Recommendation 7

We recommend that FICOM periodically perform field examinations of extra-provincial trust companies to obtain assurance that the marketing requirements of the Financial Institutions Act are being complied with. Alternatively, FICOM should seek assurance from the primary regulator that British Columbia's legislated requirements are being complied with.

Public access to audited financial statements

FICOM's normal procedures for determining if the public is given access to audited financial statements are carried out at the annual examination.

FICOM is not performing such examinations of extra-provincial trust companies. As most extraprovincial trust companies are owned by banks or other financial institutions, FICOM believes that vigorous investigation of complaints is more practical and economical than performing examinations.

We also noted that the Trust and Loan Company Act (Canada) allows for regulations addressing public access, although none have been made so far.

Coverage by the relevant deposit insurance organizations

All trust companies operating in British Columbia that take deposits must be members of the Canada Deposit Insurance Corporation (CDIC), no matter where they are incorporated. CDIC provides deposit insurance of up to \$60,000 per depositor for qualifying deposits (see Exhibit 7).

When they apply to operate in British Columbia, extra-provincial trust companies are required by FICOM to provide evidence of CDIC membership. We found that the three companies in our sample that had applied since 1990 for an authorization to operate in British Columbia had provided proof that they were, at the time, members of CDIC.

However, apart from this initial step, we found that FICOM is not checking on a regular basis to determine whether the extra-provincial trust companies operating in British Columbia are members of CDIC. FICOM relies instead on being informed if CDIC membership is withdrawn. As well, since it is likely that the withdrawal of CDIC membership would result from an accumulation of problems over a period of time, FICOM expects that it would have been informed by the primary regulator, or the company itself, of these earlier problems.

At the time of our audit, we verified that all of the extra-provincial trust companies operating in British Columbia were members of CDIC.

Recommendation 8

We recommend that FICOM verify annually that deposit-taking extra-provincial trust companies operating in British Columbia are members of CDIC.

A convenient time to do this might be during the review of the annual returns filed by the extra-provincial trust companies.

Examinations and enforcement action

As already noted, FICOM is not performing annual examinations of extra-provincial trust companies.

FICOM is allowed to make enforcement orders that extra-provincial trust companies must follow. We found that during the period of our audit it did not have reason to make any such orders.

Relying on the primary regulator of extra-provincial trust companies

As noted above, 33 out of the 41 extra-provincial trust companies operating in British Columbia are incorporated federally and regulated by the Office of the Superintendent of Financial Institutions (OSFI—see Appendix C). The remaining 8 are incorporated in, and regulated by, one of the “designated” provinces in Canada. OSFI and the regulators of the designated provinces are the primary regulators of the extra-provincial trust companies.

Because of where they are incorporated, the Financial Institutions Act does not require FICOM to ensure that these companies are properly incorporated, that their board members and senior officers meet appropriate standards (except when the company first applies for an authorization), that their related party transactions are appropriate, or that their investment and lending policies are adequate.

Although FICOM does require these companies to submit returns of their capital and liquidity, it accepts quarterly returns instead of the monthly returns required from deposit-taking institutions incorporated in British Columbia. In addition, FICOM does not carry out examinations of these companies; it relies on complaints from customers to determine whether the legislated requirements relating to market conduct are being complied with.

In effect, therefore, FICOM is relying on the primary regulator to monitor the extra-provincial trust companies.

The Financial Institutions Act requires an extra-provincial trust company to notify FICOM should the company be subject to any form of regulatory action by another regulator. In addition, FICOM has an agreement with all of the other provinces to share information, such that the provincial regulators agree to provide each other with information about routine examinations on request, and commit to notifying each other if any regulatory action is taken.

Although FICOM has not been able to enter into a similar agreement with the federal government, staff at FICOM describe their relationship with OSFI as good and say that they are able to obtain information when necessary, even if it is only oral. In addition, OSFI and FICOM have recently begun to cooperate on joint audits of the Credit Union Central of British Columbia, and FICOM has been providing assistance to OSFI in the development of regulations related to “index linked deposits,” a new product being offered by financial institutions across Canada.

As a matter of routine, FICOM requests the extra-provincial trust companies to include copies of their regulator’s examination reports in their annual returns to FICOM. However, out of our sample of 10, only 3 reports were provided for 1999. In some cases, (including the two companies in our sample regulated by other provinces) the companies said that they had not been examined that year or that no report had been issued to them. In other cases, the companies said OSFI had requested that the report not be provided to third parties without its permission.

Despite its good relationship with OSFI, we believe that FICOM needs to enter into a formal agreement with it to share information about the extra-provincial trust companies for which OSFI is the primary regulator.

Recommendation 9

We recommend that FICOM enter into an agreement with OSFI to share information about trust companies operating in British Columbia that are regulated by OSFI.

Earlier in this report, we recommended that FICOM should either periodically perform field audits of extra-provincial trust companies, or seek assurance from the primary regulator, to gain assurance that the marketing requirements of the Act were being complied with.

In fact, a number of initiatives are now under way that may affect the monitoring of the market conduct of extra-provincial trust companies. For example, the federal government has appointed a bank ombudsman, and it is also establishing a “market conduct agency” called the Financial Consumer Agency of Canada. That organization is going to oversee financial institutions, starting with banks, and eventually the other sectors (such as trust companies).

In addition, a new Canadian Financial Services Ombudsman (CFSO) is going to be established to handle, in a fair and impartial manner, the complaints of consumers and small businesses about their dealings with financial institutions. The CFSO will operate independently from financial service providers and government, with a board of directors that has a majority of non-financial institution representatives. It is intended that banks will be required to participate in dispute resolution with the CFSO, while other federally regulated financial institutions will just be required to be members of a third-party dispute resolution system. These institutions, as well as provincially incorporated financial services providers, will be eligible to join the CFSO if they wish to do so.

The intention of the Financial Consumer Agency of Canada (FCAC) is to enforce the consumer-oriented provisions of the federal financial institution statutes, monitor the industry’s self-regulatory initiatives designed to protect the interests of consumers and small businesses, promote consumer awareness, and respond to general consumer enquiries. The FCAC will bring together the existing monitoring activities that are currently dispersed among various federal entities. It will also have the regulatory tools necessary to promote financial institutions’ compliance with their consumer-related requirements under their governing statutes, including financial penalties. However, since the FCAC is a new agency, it is unclear to us how much of its resources will be devoted to examining individual financial institutions—and how much just to issuing bulletins for guidance on specific issues.

FICOM has also discussed at the provincial level an initiative whereby each province would be responsible for examining the market conduct of the extra-provincial companies incorporated in it, or incorporated federally but with their head office in the province. This initiative would initially be aimed at insurance companies, but, if successful, could be extended to all financial institutions.



response of the financial institutions commission

FICOM is in receipt of your audit report which was prepared with respect to FICOM's regulation of the credit union and trust industries in British Columbia. We appreciate receiving your report because it has provided some useful recommendations to enhance FICOM performance. Thank you.

The following are FICOM's responses to the Recommendations which you have made in your report.

1 We recommend that the Financial Institutions Commission remind credit unions of the requirement to submit changes in directors and senior officers on a timely basis.

FICOM agrees with this recommendation and it has been implemented. FICOM's Annual Filing letter of February 2001 contains a paragraph reminding credit unions to submit changes in directors and senior officers promptly.

2(a & b) We recommend that the Financial Institutions Commission extend its background checks to include any foreign countries that directors and senior officers have been residents of in the past five years.

FICOM has attempted foreign criminal record checks in the past and at best has had limited success. It is impossible to obtain a reliable criminal record check from a number of foreign jurisdictions. Nevertheless, FICOM will implement this recommendation in situations where it is practical to do so.

3(a & b) We recommend that the Financial Institutions Commission perform bankruptcy checks on all directors and officers.

FICOM agrees with this recommendation and it is being implemented. FICOM has examined the process and the requirements for undertaking bankruptcy checks for directors and senior officers and has determined that it can be done at a relatively modest cost of \$8 per enquiry. FICOM is now revising the Personal Information Return to provide for the additional information required to do the checks and anticipates implementing the Auditor General recommendation in April, 2001.

4 We recommend that the Financial Institutions Commission seek assurance from the Corporate Registry that the annual filings of credit unions and trust companies are up-to-date.

FICOM agrees with this recommendation and has implemented it. An information sharing arrangement with the Registrar is in place and is working well. As part of the annual examination program, FICOM examiners obtain information from the Registrar regarding the status of annual filings of credit unions and provincially incorporated trust companies. As well, FICOM has added this check to its annual review for extra provincial trust corporations.

5 We recommend that the Financial Institutions Commission liaise with the Registrar of Companies to ensure that future credit union and trust company incorporations are properly gazetted.

FICOM agrees with this recommendation and has implemented it.

6 We recommend that the Financial Institutions Commission develop and formally adopt an internal policy clarifying how it will verify that extraprovincial trust companies maintain “sufficient liquid assets.”

In the past, FICOM was able to rely on the requirements of the regulatory authority in the incorporating jurisdiction. This is because all regulatory authorities reviewed liquidity in the context of a specific numerical parameter (e.g. prescribed liquid assets must be at least equal to 20% of prescribed liabilities). However, the federal regulatory authorities have changed their approach to liquidity in that they no longer rely on a numerical parameter. Rather, the federal authorities require each company to establish a prudent liquidity policy taking into account the liquidity risk of the company. For this reason, the use of a numerical parameter is no longer a valid test to verify that companies maintain “sufficient liquid assets.”

FICOM appreciates the concern and the recommendation of the Auditor General. To implement the recommendation, FICOM has revised its Quarterly Filing Requirements for Extra-provincial Trust Corporations. The Quarterly Report now requires companies to provide a “Liquidity Report or verification of compliance to Liquidity Guideline or Policy” of the primary regulator. The FICOM internal policy for “sufficient liquid assets” can thus be interpreted as full compliance to the liquidity requirements of the primary regulator.

- 7 We recommend that the Financial Institutions Commission periodically perform field examinations of extra-provincial trust companies to obtain assurance that the marketing requirements of the Financial Institutions Act are being complied with. Alternatively, FICOM should seek assurance from the primary regulator that British Columbia's legislated requirements are complied with.**

With respect to the alternative, it is doubtful that any primary regulator would be prepared to expend resources to ensure that British Columbia market conduct legislative requirements are met with respect to British Columbia customers. This is particularly true with respect to the companies that are regulated by OSFI. OSFI does not have a mandate to perform market conduct regulation nor the necessary expertise to conduct such activities.

With respect to field examinations, it must be recognized that FICOM has finite resources. FICOM's on-site examination priorities are determined based on the risk to the public of a given institution or situation. In this context, violations of the market conduct requirements of the Financial Institutions Act in the context of extraprovincial trust corporations are very low on the basis of risk to the public. As a result, an investigation into the infrequent specific complaints which are received, in the view of FICOM, is a superior approach to dealing with this issue.

New federal legislation which is expected to be introduced during the spring of 2001, will establish a federal financial institution consumer protection agency. This agency is expected to have a role in market conduct regulation. When the agency is established, there may be an opportunity for FICOM to work with this agency with respect to the market conduct of extra-provincial trust corporations.

- 8 We recommend the Financial Institutions Commission verify annually that extra-provincial deposit taking trust companies operating in British Columbia are members of CDIC.**

FICOM agrees with this recommendation and will verify that all extra-provincial trust corporations conducting deposit business in British Columbia are members of CDIC as part of FICOM's annual review.

9 We recommend that the Financial Institutions Commission enter into an agreement with OSFI to share information about trust companies operating in British Columbia that are regulated by OSFI.

FICOM is of the view that the informal arrangements with OSFI are satisfactory for FICOM's purpose. Nevertheless, FICOM will raise the issue with OSFI.

This concludes FICOM's comments. Once again, thank you for your work in helping to make FICOM a more effective regulatory organization.



appendices



appendix a

Credit Union Central of British Columbia (CUCBC)

The Credit Union Central of British Columbia (CUCBC) is the provincial trade association incorporated in the province under the Credit Union Incorporation Act. Each credit union in British Columbia is a member of CUCBC, buying shares in it and depositing funds with it. Most provinces have a central credit union, and CUCBC, like all the others, is a co-operative organization that supplies products and services to individual member credit unions.

As a central credit union, CUCBC must comply with some of the provisions of the federal Cooperative Credit Associations Act. This means that CUCBC is subject to federal regulation and inspection, carried out by the federal Office of the Superintendent of Financial Institutions. Under an agreement with that office, FICOM shares the supervisory responsibilities for CUCBC, carrying out alternate examinations, and relying on one another's work.

The Credit Union Central of Canada is responsible for maintaining the liquidity of the Canadian credit union system. Under an agreement with the Credit Union Central of Canada, CUCBC is responsible for the liquidity of British Columbia's credit union system. In addition, CUCBC is also a member of the Canadian Payments Association. As a clearing bank, CUCBC gives British Columbia credit unions access to the Canadian payments system, allowing them to clear cheques with, and transfer funds to and from, other credit unions, trust companies and banks in British Columbia, across Canada and internationally. Therefore, CUCBC has two main roles: it helps to maintain the liquidity of British Columbia credit unions, and it acts as a clearing bank for them.

To maintain the liquidity of British Columbia credit unions, CUCBC is required to hold in a segregated fund, under the control of a custodian, 2% of the aggregate assets of each individual credit union. In addition, another 4% of each credit union's assets must be invested by that credit union in qualifying assets. Combined, these two deposits of each credit union in British Columbia must total 6 percent of its aggregate assets. Each credit union must also have funds on deposit with CUCBC that are equal to that credit union's "minimum liquidity."

CUCBC also provides member credit unions with a wide range of ongoing support services. These services include regular updating of financial information, asset/liability management, research and development, marketing and communications, education, management services, negotiating on behalf of the member credit unions and representing credit union interests on proposed provincial legislation. Examples of these services are the development of the operations manual for member credit unions and the Director's training program.

CUCBC is funded by the annual assessments levied on credit unions as well as by its earnings on deposits, loans and investments.



appendix b

Stabilization Central Credit Union (SCCU)

The Stabilization Central Credit Union (SCCU) was created by the Financial Institutions Act in 1989 in response to industry's demand for an organization to strengthen the monitoring function of credit unions. Credit unions decided that they needed a specific body that could move quickly to avert any solvency problems—thereby protecting the public as well as the reputation of the industry.

Although created under the Act, SCCU is a central credit union owned and controlled by British Columbia credit unions. It functions as a self-policing entity and works with credit unions either on its own initiative or formally on behalf of FICOM when supervision of specific credit unions is required. All credit unions must be members of SCCU.

The mission of SCCU is to:

- ensure and enhance efficient operation of the credit unions and to protect members' deposits at a reasonable cost;
- resolve problems within the credit union system without the financial assistance of the Credit Union Deposit Insurance Corporation (CUDIC); and
- monitor member credit unions and apply peer pressure on poor operators to prevent damage on the system.

It conducts many financial and performance monitoring functions, such as:

- monitoring credit unions' performance to identify emerging risk and activate timely intervention;
- assisting credit unions with problems in resolving identified difficulties;
- developing programs to increase credit union self-discipline;
- supervising credit unions with problems as requested by FICOM; and
- maintaining a stabilization fund in conjunction with CUDIC to assist credit unions should any short-term solvency issues arise.

As well, SCCU provides general system-wide guidance. Recently, for example, it issued “Standards of Sound Business & Financial Practices” to each credit union. These standards include a compliance self-assessment checklist. Credit unions are expected to complete the checklist annually and forward a copy to SCCU.

Funding for SCCU comes from assessments levied on the credit unions. In 1999, this levy was $2\frac{1}{2}$ 100^{ths} of 1% (ie 2.5 basis points) of the deposits of credit unions.



appendix c

Office of the Superintendent of Financial Institutions (OSFI)

The Office of the Superintendent of Financial Institutions (OSFI) is responsible for regulating and supervising federally regulated financial institutions. These include federally incorporated trust companies, all banks, and all federally incorporated or registered insurance companies, loan companies, cooperative credit associations, fraternal benefit societies, and pension plans.



appendix d

Credit Union Deposit Insurance Corporation of British Columbia (CUDIC)

The Credit Union Deposit Insurance Corporation of British Columbia (CUDIC) was established under the Credit Union Act and continued under the Financial Institutions Act. The mandate of CUDIC is to guarantee deposits and non-equity shares of depositors in British Columbia credit unions up to the limits prescribed by the Financial Institutions Act and its regulations.

The directors of CUDIC are drawn from the commissioners of FICOM. CUDIC has no staff. Such administrative services as it needs are provided by FICOM, which is reimbursed by CUDIC for the cost of providing the services.

CUDIC undertakes the administrative functions set out in the Financial Institutions Act, including making deposit insurance payments and providing assistance to credit unions.

Based on historical payouts and ongoing analysis, CUDIC has concluded that a minimum deposit insurance fund balance equal to 55 basis points of credit union deposits is needed.

To maintain the deposit insurance fund, CUDIC is empowered to assess credit unions an annual fee, calculated as a percentage of the deposits of credit unions at their previous year end. The percentage is determined by the commissioners, but is limited by the Financial Institutions Act to $\frac{3}{10}$ ths of 1%. The fee levied during 1999 was calculated as $2\frac{1}{2}$ 100ths of 1% (ie 2.5 basis points).

Once the commission has determined the annual levy, FICOM staff calculate the amount for each credit union, and this is deducted from their holdings at the Credit Union Central of British Columbia.

In addition to the funds raised from these levies, the Stabilization Central Credit Union has provided CUDIC with an irrevocable letter of credit for the fund.

At the time of our audit, the SCCU's letter of credit was for \$50 million, and at March 31, 1999, the accumulated fund balance of \$74.2 million and the SCCU \$50 million letter of credit represented 64 basis points of credit union deposits. Subsequent to our audit, SCCU had entered into a new

arrangement whereby the amount of the letter of credit is equal to the difference between 55 basis points of credit union deposits and the CUDIC fund balance. The amount of the letter of credit is determined each July, and is currently \$30 million.

If the fund is considered to be impaired, an additional assessment of $\frac{1}{12}$ th of 1% may be made during the year. If that is still not enough, the Lieutenant-Governor in Council can direct the Minister of Finance to guarantee the amount needed to replenish the fund. CUDIC may also raise money by issuing debentures.

The assistance that CUDIC provides to credit unions is not just financial. It also provides guidance on credit union rehabilitation, mergers and liquidation.



appendix e

Office of the Auditor General: 2000/01 Reports Issued to Date

Report 1

Fostering A Safe Environment: How the British Columbia School System is Doing

Report 2

Report on the Implementation of the Recommendations of the Budget Process Review Panel

Report 3

Follow-up of Performance and Compliance Reports

Report 4

Management Consulting Engagements in Government

Report 5

Monitoring Credit Unions and Trust Companies in British Columbia



appendix f

Office of the Auditor General: Compliance Audit Objectives and Methodology

Audit work performed by the Office of the Auditor General falls into three categories:

- Financial auditing;
- Performance auditing; and
- Compliance auditing.

Each of these categories has certain purposes and objectives that are expected to be achieved, and each employs a particular form of audit practice to meet those objectives. The following is a brief outline of the objectives and methodology applied by the Office for compliance auditing.

Authorities

Under our Canadian system of government, laws approved by parliament and provincial legislative assemblies are of paramount importance to our society.

Acts passed by the Legislative Assembly of British Columbia, including the Supply Acts, the Financial Administration Act, the Financial Information Act, and many others, provide the government and government organizations with direction on managing resources entrusted to them by the public, and on being accountable to the Legislative Assembly for the execution of these responsibilities. These Acts, or statutes, provide the legal basis for funding, delivering and administering the Province's social, economic, environmental and other programs.

Accordingly, it is important that the government ensures compliance with these statutes and related authorities. It is also important that this compliance be independently reviewed to ascertain whether public sector activities are carried out *intra vires* (within the scope of their authority). This is where compliance auditing plays an important role.

Compliance Auditing

Purpose of Compliance Audits

The purpose of compliance audits is to provide an independent assessment as to whether or not legislative and related authorities are being complied with, in all significant respects.

In addition to separate compliance audits, the Office of the Auditor General also performs financial audits and performance audits. While auditing for compliance with legislative and related authorities is the primary objective of compliance audits, auditing for compliance with authorities may also be included as part of financial audits or performance audits where there are authorities that are relevant to the objectives of those audits.

Nature of Legislative and Related Authorities

Legislative and related authorities include legislation, regulations, orders in council, ministerial orders, directives, by-laws, policies, guidelines, rules and other instruments, including codes of ethics or conduct. Through these authorities, powers are established and delegated.

Legislation may delegate broad powers to governments, ministers and officials who, in turn, may establish other related authorities, such as policies, to provide more detailed requirements that must be complied with by the organizations concerned. Such authorities are subordinate to enabling legislation and must not contradict or go beyond the directions and limitations set out in that legislation.

These authorities represent a basis for legislative control over the source and use of public resources, the operation and administration of programs, and the manner in which organizations are held accountable for choices made in the exercise of their functions. The structure thus has pervasive effect on the activities of governments and other publicly accountable organizations. Authorities also form the basis for communication between elected officials and the bureaucracy.

Audit Standards

Auditors are expected to comply with established professional standards, referred to as generally accepted auditing standards. Our compliance audits are conducted in accordance with generally accepted auditing standards established by the Canadian Institute of Chartered Accountants (CICA). These consist of the general, examination and reporting standards prescribed in the CICA Handbook.

Audit Selection

We generally select specific sections in an Act, or in several Acts, having common objectives. In most instances, we do not audit all aspects of an Act in the course of one audit.

The primary legislative instrument which provides for administration of the financial affairs of the Province is the Financial Administration Act. Therefore, compliance with this Act is of regular and ongoing significance to our Office. Other legislation and related authorities are considered for audit purposes on a more cyclical basis, depending on such factors as: the extent of impact on government, non-profit or private organizations and the public; the significance of financial accountability reporting requirements; the degree of interest by legislators and the public; and the likelihood and impact of non-compliance with legislated requirements.

Audit Process

The audit process adheres to the professional standards mentioned above. Of particular note is that compliance-with-authorities audits differ from other audits in their degree of dependence on the identification of relevant authorities and the interpretation of the meaning of the specific authorities being audited.

In order to identify the relevant authorities, the auditor must obtain an in-depth understanding as to how the authorities are themselves approved and how relevant authorities can be identified. The audit process includes determining that related authorities are within the limits prescribed by legislation, and that there are no obvious inconsistencies, contradictions or omissions in the authorities.

In addition, whether or not an authority is being complied with will often depend on its clarity, and the consistency in which its meaning is interpreted. Because of the importance of such interpretations, we seek professional legal advice where necessary.

In an examination designed to report on compliance with authorities, we seek reasonable assurance that the authorities specified in the audit report have been complied with, in all significant respects. Absolute assurance in auditing is not attainable because of such factors as the need for judgment, the use of testing, and the inherent limitations caused by differing interpretations in the meaning of authorities.

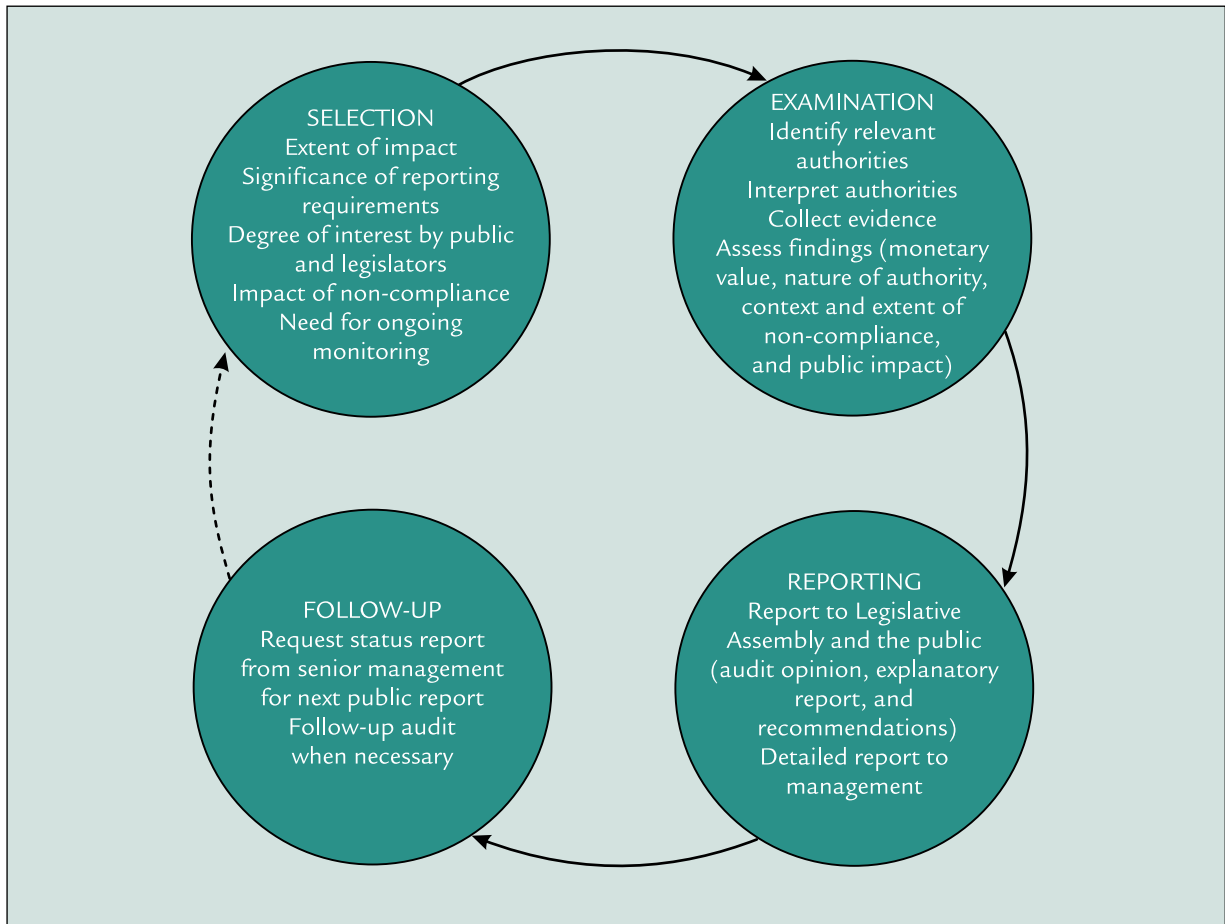
Reporting the Results of Audits

Our public report on each audit is in two parts: a formal audit report, showing the scope of the audit and our overall opinion on compliance, and a more detailed, explanatory report.

Exhibit 8

Compliance Audit Stages

An outline of the activities performed at each stage



The formal report includes the auditor’s professional opinion on whether or not the authorities that are the subject of the audit have been complied with, in all significant respects.

Our main considerations in assessing significance of non-compliance include monetary value, the nature of the authority or finding, the context within which compliance is to occur, and public interest.

In addition to the formal audit report, we provide a more detailed report that includes an explanation of what is required by the legislative and related authorities, the scope of our audit work, our overall observations, our detailed audit findings, and any other related observations.

When considered appropriate, we also make recommendations. The recommendations fall generally into three categories: to improve compliance with the legislative and related authorities; to improve operational effectiveness of the entity responsible for ensuring compliance; and, on occasion, to provide useful suggestions for improvements to existing authorities where they may have become administratively impractical or out of date.

There may be minor instances of non-compliance that either may not be detected by the audit or may not be worthy of inclusion in the report. We exercise professional judgement when assessing the significance of any non-compliance. For example, the needs of users of the report, the nature of the relevant authorities, and the extent of non-compliance must, among other things, be considered. As well, the significance of any non-compliance often cannot be measured in monetary terms alone.

We sometimes also issue a detailed management report of our findings to the ministry responsible for the legislation or the organizations affected by it. The relevant ministries or organizations are thus given an opportunity to respond to our findings, and we take this into account in the preparation of our public report.

When our public report on compliance audits completed in the past year is published, it is reviewed by the Select Standing Committee on Public Accounts of the Legislative Assembly of British Columbia. Recommendations made by the Committee in relation to our reports are followed up bi-annually by our Office with the ministries responsible to obtain from them a status report on their progress in implementing the Committee's recommendations. These status reports will be included in our next public report on compliance audits.



Compiled and typeset by Graphic Designer, Debbie Lee Sawin, of the Office of the Auditor General of British Columbia
and published by the Queen's Printer for British Columbia®
Victoria 2001

