Federal

FINANCIAL SECTOR FRAMEWORK

Review

Second Consultation Paper

September 29, 2017

About The Co-operators

The Co-operators Group Limited (“The Co-operators”) is a leading Canadian, diversified, integrated, multi-line insurance and financial services organization with $44.9 billion in assets under administration. Our member organizations, 42 co-operatives and credit union centrals across the country, represent a combined membership of millions of Canadians. We are proud to provide financial security to Canadians in their communities while staying true to our co-operative values.

As a co-operative, concern for the community is one of our founding principles. That is why, in 2016 alone, The Co-operators contributed over $7.5 million, which represents 4.1% of our pre-tax profit, to Canadian charities and community organizations across the country.

Within our group of companies Addenda Capital Inc. is responsible for investing more than $28 billion in assets for pension funds, insurance companies, foundations, endowment funds and third party mutual funds of major financial institutions. Addenda’s approach to sustainable investment focuses on integrating environmental, social, and governance issues into investment processes. Addenda became a signatory to the United Nations-supported Principles for Responsible Investment in 2012 and to the Montreal Carbon Pledge in 2015.

Business profile

- **4,992** employees
- **500** exclusive financial advisors
- Insures **805,000** homes, **1.3 million** vehicles and protects **629,000** lives
- Provides coverage to **38,000** farms and **295,000** business
- Serves approximately **300** credit unions with more than **5.5** million members

Introduction

Canadians expect their government to monitor and examine the financial sector to ensure it remains stable and efficient. The current review of the Federal Financial Sector Framework is a critical opportunity to reflect on the purpose of Canada’s financial sector and make substantive improvements that will enable Canada to become more prosperous and inclusive in the future. We agree the global economy is changing rapidly. As innovation, technology, consumer preferences, and climate change evolve, the framework must adapt as well.

We believe it is critical to mobilize Canada’s financial sector to enable the transition to a sustainable, low-carbon, climate-resilience society. While we agree that the policy issues set out in the Department’s second consultation document are critical, The Co-operators believes certain risks to the sector warrant further consideration.

Climate change, changing attitudes and values on incorporating environmental, social and governance considerations into financial decisions and the changing nature of financial market participation are just a few additional policy considerations. We must effectively identify and leverage the mitigation and adaptation efforts and the business opportunities associated with 21st century risks and changing societal expectations.

In order to fulfill these challenges and opportunities, the role of the financial sector must be harnessed as a means to achieve a transition to a sustainable, low-carbon, climate-resilient society.

Multi-level collaboration between stakeholders is paramount to shift the insurance industry, the economy, and communities towards sustainability and long-term resiliency. We appreciate the opportunity to provide further comment on the Second Consultation Paper: "*Potential Policy Measures to Support a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future*" (the "Paper").

Supporting a Competitive and Innovative Sector

Innovation is a key element of a healthy, sustainable economy. Strong competition drives innovation, which in turn provides consumers with more choice and higher quality products and services. However, we are experiencing a rapidly changing global economy, where innovative technologies are disrupting traditional markets and long-standing business models. As a result, it is imperative that the framework be structured to foster competition and innovation in the marketplace to maximize the benefits of an inclusive economy for all. We are pleased to note the Paper referenced the Department's emphasis on ensuring that the financial sector is serving and driving inclusive economic growth.

Competition in the financial sector can be a tool to deliver economic growth. In this context, the Department is seeking views on how to best ensure that the financial sector supports long-term economic growth, while balancing the need for a well-functioning and stable sector, and in particular, the role that small and mid-sized banks can play in enhancing the innovative and competitive potential of the Canadian economy.

Understanding that although the Department is seeking specific feedback on the contribution of small and mid-sized banks in the discussion around **Positioning a Competitive and Innovative Sector to Support Long-Term Economic Growth**, we would like to provide further comment on the role of the financial sector in supporting *long-term economic growth*.

In order to better anticipate and position Canada to leverage systemic change and ensure we are prepared to not only respond but to shape that future, we need to define a vision of a sustainable Canadian financial system.

For instance, the United Nations' Inquiry into the Design of a Sustainable Financial System work has researched financial and monetary policies, regulations, standards, disclosure requirements, credit ratings, listing requirements and indices, analyzing the effectiveness of each in helping to align financial systems with sustainable development. In Europe, the High-Level Expert Group on Sustainable Finance recently issued an interim report on how the European Union can develop a comprehensive strategy on sustainable finance. Canada can benefit from this, and similar work, to assess the policies best suited to support the government's mandate and meet its climate commitments.

We call on government to bring together a small group of key government and business leaders, sustainable finance experts, and leading international thinkers to explore the development of a roadmap for Canada as a positive first step.

Modernizing the Framework

The financial sector plays a key role in the process of economic development and growth. However, in order for it to remain up to date and effective, the framework must keep pace with new developments and best practices. As a result, The Co-operators agrees with the paper that modernizing the federal financial sector framework will better allow federally regulated life and health insurers to respond to the changing macroeconomic environment, as well as the rising expectations of corporate governance and transparency.

Specialized Infrastructure Investment Powers: The Department is seeking views on whether to provide federally regulated life and health insurers with additional investment powers in infrastructure. The Department is also seeking views on the conditions that should applied to additional infrastructure investment powers of life and health insurers so as to protect policyholders and maintain long-standing limitation on commercial investments.

Federally regulated financial institutions often invest in other financial institutions and in commercial areas to build their asset portfolios and to meet long-term insurance policy obligations. However, limitations surrounding commercial investment powers have hindered insurers from being able to adapt to evolving business environments.

There is much more to be gained than financial return when investing. With the ability to further invest in infrastructure, life and health insurers would be better positioned to deal with some of society's major issues. Often referred to as *impact investing,* companies can turn a profit while doing good for the community, the environment, and society at large. Specific examples may include renewable energy, affordable housing, postsecondary education, and clean transportation; all in which require appropriate and accompanying infrastructure.

In a recent letter to the Ontario Minister of Environment and Climate Change regarding the establishment of a "green bank", we noted that a significant barrier holding back mainstream investments into sustainable investing is the small scale of investment opportunities.

The Co-operators believes that it is possible to balance economic, environmental, and social priorities as a responsible corporate citizen, should insurers be given additional investment powers.

Corporate Governance

We are pleased to see an emphasis on corporate governance highlighted as a central tenant of public confidence in the financial sector. *As we already noted in our submission to the first consultation paper, many of the corporate governance improvements proposed in Bill C-25, An Act to amend the Canada Business Corporations Act, the Canada Cooperatives Act, the Canada Not-for-profit Corporations Act, and the Competition Act, should also apply to businesses overseen by the Office of the Superintendent of Financial Institutions*.

Below are our specific comments.

Promoting Diversity on Boards: The Department is seeking views on whether to implement a 'comply or explain' model to promote the participation of women on boards of directors and in senior management of federally regulated financial institutions.

As we noted in our first submission, there is a strong business case for higher levels of gender diversity on boards of directors and among executive officers than currently exists. The Co-operators recognizes and values the benefits of having a diverse Board of Directors and considers diversity a key driver of our co-operative identity, competitive success, and governance strength. It is important for organizations to be governed by a mix of highly qualified directors from diverse backgrounds that contribute a broad range of perspectives and experiences to its discussions and decisions, ultimately promoting the best possible governance. *Therefore, we support the implementation of a 'comply or explain' model to promote the participation of women on boards of directors and in senior management of federally regulated financial institutions*.

Achieving parity of men and women on boards in the co-op sector presents additional complexities due to its democratic ownership structure, as directors are usually not actively recruited but rather elected by the members. The Co-operators aspires to be reflective of the Canadian demographic within our governance framework and is committed to increasing the percentage of women on our Board. Our current policy establishes a target to achieve at least 30 percent women directors by 2020 and 50 percent women directors longer term. As the pool from which The Co-operators directors are nominated and elected is the delegate body, a further goal was set to achieve a 50/50 gender balance within the delegate pool.

Given our democratic governance structure, which includes a director election and delegate appointment process, we recognize it will take time to reach our targets, and ultimately, our ability to achieve our stated goals will need support and action beyond The Co-operators. We have taken steps, such as enhancing the delegate appointment and director nomination process communiques to clearly articulate The Co-operators goals, asking members to give consideration to the company's goals when nominating and electing individuals to serve on our board of directors. While new tactics have been implemented and some progress has been made, we continue to actively reach for our goals.

One of the other ways we are seeking to achieve greater gender diversity within our leadership roles is to encourage more women to put forward their applications, in order to develop a "pipeline of candidates". We are actively identifying barriers that may either prevent or inhibit women from advancing their careers, while at the same putting appropriate training, coaching and mentoring supports in place. We are monitoring our progress to ensure that the percentage of women in leadership roles is indeed increasing.

Establishing Annual Elections: The Department is seeking views on whether to establish annual elections for directors with fixed, one-year terms for all federally regulated financial institutions. For small institutions, the Department is considering whether to provide a two-year transition period and seeking views on the unique implications for these institutions.

We support annual elections for directors with fixed, one-year terms for all federally regulated financial institutions.

Mandating Individual Director Elections: The Department is seeking views on whether to mandate individual director elections for all federally regulated financial institutions. For small institutions, the Department is considering whether to provide a two-year transition period and is seeking views on the unique implications for these institutions.

As a co-operative, we have a member-driven director nomination and election process. In principle we do not support electing a slate of directors, but rather individual directors being elected on individual basis/merit.

Majority Voting for Directors of the Board in Uncontested Elections: The Department is seeking views on how a majority voting standard could work in an uncontested election for directors of federally regulated institutions, while ensuring minimum disruptions to the operations of a board and continued stability in the case of a failed election of a candidate.

Although our democratic structure does not align with uncontested elections, we are supportive of this approach. The Canadian Coalition for Good Governance has suggested how a majority voting policy could be implemented on their website.[1]

[1] Canadian Coalition for Good Governance. 2011. Majority Voting Policy. Retrieved on 2017-09-21 from http://www.ccgg.ca/site/ccgg/assets/pdf/2011_MV_Policy.pdf

Distributing Meeting Materials: The Department is seeking views on whether to permit the use of the "notice and access" approach for all federally regulated financial institutions. For small institutions, the Department is seeking views on whether this approach would be beneficial.

The Department should permit the use of the "notice and access" approach for all federally regulated financial institutions.

Federal Credit Unions and the Cooperative Associations Act: The Department is seeking views on the merits of maintaining or repealing the Cooperative Credit Associations Act.

We understand that the Cooperative Credit Associations Act was put in place to allow credit union centrals (provincially regulated) to get legislative coverage for their activities. Since then, the Bank Act has incorporated these efforts at the federal level. If there are no active institutions currently subject to the Cooperative Credit Associations Act, repealing it would create greater clarity.

Limitations on Using the Terms 'Bank,' 'Banker,' and 'Banking': The Department is seeking views on whether prudentially regulated non-bank deposit-taking institutions should be given flexibility to use the terms 'bank' or 'banking' to describe their activities and services in appropriate circumstances. Feedback is welcomed on how to refine the limitations on the use of these terms and on how to avoid marketplace confusion and ensure appropriate protection of consumers.

As noted earlier in our introduction, as a co-operative, our 42 member-organization include co-operatives and credit union centrals. Through CUMIS Group Limited, we are a leading provider of insurance-related products and services to the Canadian credit union system, serving over 300 credit unions with a total of more than five million members.

Like other financial institutions, credit unions provide chequing accounts, mortgages, business loans, and investment advice. However, all Board of Directors of credit unions are democratically elected members of their community.

On June 30, 2017, the Office of the Superintendent of Financial Institutions (OSFI) issued an advisory that adopted a strict interpretation of *Bank Act* restrictions around the use of the words "bank, banker and banking" by non-banks like credit unions.

We believe credit unions should not be forced to invent new words to replace the terms Canadians already use to describe their dealings with regulated institutions like credit unions.

We support changes to the *Bank Act* to make clear that credit unions, as regulated deposit-taking institutions, can use these terms to describe what they do while ensuring that Canadians know they are dealing with a credit union, not a bank.

The Canadian Credit Union Association (CCUA) estimates that a ban on the use of these words would force credit unions to pay up to $80 million to remove phrases like "on-line banking," "mobile banking" and "commercial banking" from signage, websites, forms and advertising.

The enforcement of an outright ban would make it harder for credit unions to compete with banks. Credit unions would have had to spend millions of dollars to popularize new terms to replace common phrases like "online banking," "business banking," or "bank with a credit union" and even then, could still be vulnerable to an enforcement action by OSFI.

We recommend the Department of Finance propose changes to the Bank Act that would allow credit unions, as prudentially regulated deposit-taking institutions, to use the terms "bank" and "banking" to describe their activities and services.

Safeguarding a Stable and Resilient Sector

We applaud the Government's focus on maintaining a stable and resilient financial sector as it is critical not only to a healthy Canadian economy, but to the financial well-being of Canadians. In our response to the first consultation paper, we identified climate change as having a large-scale impact on Canada's economy, with flooding becoming the most common type of natural disaster. This is why, we continue to highlight the need for the financial sector to be harnessed as a means to achieve a transition to a sustainable, low-carbon, climate-resilient society. We have specific comments on earthquake insurance and climate-risk disclosure to provide.

Earthquake Insurance

The Department is considering how to limit the system-wide risks an extreme earthquake could pose to federal property and casualty insurer, and will be consulting with provinces, territories, and stakeholders. In addition, the FCAC intends to improve consumer education products related to catastrophic risk and insurance to develop consumer awareness of insurance products and consumer rights and responsibilities, and will seek out opportunities to collaborate with provincial and territorial governments.

We agree that improving consumer awareness related to catastrophic risk should be a point of focus for the Financial Consumer Agency of Canada (FCAC). Effective insurance coverage requires consumers to understand and manage their risks. The Co-operators is committed to communicating with clients about catastrophic risks so they can better understand their insurance coverage and how they can help mitigate those risks.

Damage caused by earthquake is not part of the home policy and needs to be added by endorsement. This is why, for example, when selling new policies in British Columbia, our process currently includes earthquake coverage in the quote as British Columbia is the province most at risk. By the end of 2017 we will have implemented this process for all jurisdictions. We want to ensure conversation with all clients at the point of sale - although the coverage is added separately to the policy, it is extremely important.

A 2014 survey[2] conducted by the Insurance Bureau of Canada (IBC) found that 70 per cent of Canadians in British Columbia and 91 per cent in the Ottawa-Montreal-Quebec City corridor never considered purchasing earthquake coverage mainly because they don't believe earthquake is a risk. Similarly, a recent survey on flood risk[3] by Partners for Action (P4A), a network at the University of Waterloo's Faculty of Environment supported by The Co-operators and Farm Mutual Re, found that of the 2,300 Canadians in "at risk flood areas", only 6% of respondents felt they were at risk for flooding.

This ultimately highlights the need for more awareness and education. Cost was not the number one deterrent. While we are beginning to see an upward trend of our British Columbia clients choosing earthquake coverage, there continues to be a gap in earthquake prone areas of Eastern Canada where take-up rates continue to be significantly lower than those seen in British Columbia.

However, while we provide information to educate consumers, the insurance industry cannot do this alone; it must be a joint effort with all levels of government, financial institutions, builders, realtors, and conservation authorities to name a few.

We were pleased to see Consumer Awareness and Understanding of Risks and Coverages Related to Natural Catastrophes highlighted as a key strategic initiative in the Canadian Council of Insurance Regulators (CCIR) 2017-2020 Strategic Plan and have expressed our interest in supporting and moving this important work forward.

One additional comment we would like to make is around the role of the banking industry and other mortgage providers in educating consumers about earthquake risks. As noted in the Paper, OSFI requires large banks to assess their own earthquake exposures, including the potential costs of increases in mortgage defaults. It is our understanding that currently there is no confirmation required that a mortgagee has earthquake insurance or has sufficient earthquake insurance to cover mortgage liabilities in particular for those in areas that are at a high risk for earthquake.

[2] Insurance Bureau of Canada. (2014-10-14). Survey shows Canadians do not believe earthquake is imminent. Retrieved from http://www.ibc.ca/nu/resources/media-centre/media-releases/survey-shows-canadians-do-not-believe-earthquake-is-imminent

[3] Peddle, S., Henstra, D., Scott, D., and Thistlethwaite, J. (2016-09-13). Informing Flood Management Policy in Canada: Experiences and Opinions of Homeowners. Retrieved from http://www.livablecitiesforum.com/wp-content/uploads/2014/04/1-Peddle_LCF_13Sept16_fnl.pdf

We recommend that the banking industry (and other financial services providers that issue mortgages) require their clients to identify their earthquake risk and strongly encourage them to buy sufficient insurance to be able to rebuild their home.

The impact of not doing so may result in a significant amount of economic loss that is not insured which would have a negative impact on the economy. Beyond that direct impact, if a client did not purchase enough insurance to rebuild their home and replace their contents to the same standard of living as they had before, then they will have less disposable income to invest in luxury items which will impact the retail sector and others.

Climate Risk Disclosure

In the words of the Bank of Canada, “climate change itself and actions to address it will have material and pervasive effects on Canada’s economy and financial system.”[4] From a physical perspective, the Intergovernmental Panel on Climate Change (IPCC) has documented many observed changes in the climate system, for which anthropogenic drivers are the dominant cause.[5] The IPCC has also highlighted that many aspects of climate change and associated impacts will continue to occur for centuries, and without sufficient mitigation efforts, there is a “high to very high risk of severe, widespread and irreversible impacts globally.”

Global efforts to mitigate the impacts of climate change culminated in the Paris Agreement. After two decades of failed attempts, a global and historic climate agreement was approved unanimously by 195 countries in December 2015. The agreement aims to keep global warming well below 2 degrees Celsius, but also to pursue efforts to limit the temperature increase to 1.5 degrees, which would significantly reduce the risks and impacts of climate change. The estimated greenhouse emission reductions required to achieve these ambitious targets are noteworthy and will significantly alter the global economy as we transition to a low-carbon economy.

In Canada, the federal government’s Intended Nationally Determined Contribution (INDC) is to, “achieve an economy-wide target to reduce its greenhouse gas emissions by 30% below 2005 levels by 2030.”[6] Canada's Mid-Century Long-Term Low-Greenhouse Gas Development Strategy discusses a pathway consistent with reducing greenhouse gas emissions by 80% below 2005 levels by 2050[7]. Such a significant reduction will require, “a fundamental restructuring of multiple sectors of the economy.” For instance, “the electrification of end use applications that are currently using fossil fuels is fundamental.”

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[4] Bank of Canada. (2017-03-02). *Thermometer Rising – Climate Change and Canada’s Economic Future*. Retrieved from http://www.bankofcanada.ca/2017/03/thermometer-rising-climate-change-canada-economic-future/

[5] IPCC. (2014). *Climate Change 2014: Synthesis Report. Contribution of Working Groups I, II and III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change* [Core Writing Team, R.K. Pachauri and L.A. Meyer (eds.)].

[6] Canada. (2015-05-15). *Intended Nationally Determined Contribution – Canada*. Retrieved from http://www4.unfccc.int/Submissions/INDC/Published%20Documents/Canada/1/INDC%20-%20Canada%20-%20English.pdf

[7] Canada. (2016-11-17). Canada's Mid-Century Long-Term Low-Greenhouse Gas Development Strategy. Retrieved from http://unfccc.int/files/focus/long-term_strategies/application/pdf/can_low-ghg_strategy_red.pdf

Investor and issuer understanding of the scope of risks and opportunities related to climate change is evolving, and the regulatory environment should evolve with it. Given the overwhelming evidence that climate change and related actions will materially alter Canada's economy, it is clear that climate change is sufficiently important to warrant specific disclosure obligations beyond the disclosure obligations regarding material information that individual issuers must adhere to.

As noted in the Paper, the final recommendations of the Financial Stability Board's industry-led Task Force on Climate-related Financial Disclosures (TFCD) were released on June 29, 2017.

As an organization, we are currently evaluating how we can move forward with the four focus areas of governance, risk, strategy and metrics. As an insurer, we see value in businesses implementing the TCFD's recommendations. As an investor, we require effective disclosure from the organizations in which we invest. Much of the information we need is included in mainstream financial filings but some information is missing or it's disclosure does not adhere to principles of effective disclosure. Disclosure relating to governance, environmental, and social issues is often lacking, particularly related to climate change.

Such disclosures will enable companies to better understand what and how to report and enable investors to better access information needed to assess portfolio risks. In addition to reporting, it will also allow businesses to better prepare themselves to the risks of climate change.

The Co-operators annually discloses our corporate carbon footprint and have begun to disclose the carbon footprint of our investment portfolio. Our 2016 disclosures are available in our latest Integrated Report.

Further, The Co-operators is actively engaged in various leadership groups promoting more fulsome disclosures of climate and other environmental, social and governance information. We are founding members of both Smart Prosperity and Corporate Knights' Council for Clean Capitalism, and internationally we work with various initiatives of the United Nations Environment Programme. In 2016, we advised a project led by the Chartered Professional Accountants of Canada to review the climate-related disclosure practices of 75 TSX-listed companies, then funded a complementary review of the same practices by ten co-operatives and credit unions.

Concluding Remarks

The aforementioned United Nations' Inquiry into the Design of a Sustainable Financial System calls for a realignment of the financial system and identifies short termism as an issue and suggest government and governance structures be re-calibrated to align with long-term outcomes. Sustainable development principles must be incorporated in mandates and performance measures.

While we are pleased to see certain elements highlighted in this Paper, such as green finance and climate related disclosures, more can and must be done. Pension fund disclosures, executive compensation, investor stewardship, as well as consideration of technological changes in society beyond financial technologies (such as autonomous vehicles for example), are just a few additional areas that should be considered in the near-term.

On behalf of The Co-operators group of companies, thank you again for the opportunity to provide comments on the Department of Finance's second consultation paper on the review of Canada's Federal Financial Sector Legislative and Regulatory Framework.

Please do not hesitate to contact Maya Milardovic, Director of Government Relations, at maya_milardovic@cooperators.ca for any further feedback, clarification or updates on next steps in the consultation process.

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