

# **GUIDELINE GOVERNING INTEGRITY AND COMPETENCY CRITERIA**

October 2011

## Table of Contents

<b>Preamble .....</b>	<b>2</b>
<b>Introduction .....</b>	<b>3</b>
<b>Scope .....</b>	<b>4</b>
<b>Coming into effect and updating.....</b>	<b>5</b>
<b>Integrity and Competency: foundation for good governance .....</b>	<b>6</b>
<b>Management framework for integrity and competency criteria .....</b>	<b>7</b>
<b>Governance of decision-making bodies .....</b>	<b>8</b>
<b>Role of the board of directors.....</b>	<b>8</b>
<b>Integrity and competency assessment criteria .....</b>	<b>9</b>
<b>Compliance with the assessment policy and decision-making process.....</b>	<b>11</b>
<b>Changes in composition of decision-making bodies.....</b>	<b>13</b>
<b>Supervision of sound and prudent management practices .....</b>	<b>14</b>

## Preamble

The *Autorité des marchés financiers* ("AMF") establishes guidelines setting out its expectations with respect to financial institutions' legal requirement to follow sound and prudent management practices. These guidelines therefore cover the execution, interpretation and application of this requirement.

The AMF favours a principles-based approach rather than a specific rules-based approach. As such, the guidelines provide financial institutions with the necessary latitude to determine the requisite strategies, policies and procedures for implementation of such management principles and to apply sound practices based on the nature, size and complexity of their activities.

The AMF considers governance, integrated risk management and compliance (GRC) as the foundation stones for sound and prudent management of financial institutions and, consequently, as the basis for the prudential framework provided by the AMF.

This guideline is part of this approach and sets out the AMF's expectations regarding sound and prudent management practices in assessing integrity and competency criteria.

## Introduction

Financial institutions play a vital role in the economy and their operations often have a direct impact on consumers, particularly as regards the protection of insureds and depositors. Maintaining confidence in financial institutions and the financial sector in general is of importance to the AMF.

The accountability of boards of directors and senior management of financial institutions carrying on business in Québec is the premise that underlies the AMF's preferred approach to providing a supervisory framework. The AMF considers the integrity and competency of members of decision-making bodies<sup>1</sup> to be intrinsic elements for good governance; these elements must form an integral part of the institution's culture. Deficiencies in this regard could ultimately have a negative impact on an institution's reputation and solvency.

Consequently, in order for the AMF to be reasonably assured that this premise has been attained, integrity and competency must be key elements within a financial institution. As such, this guideline sets out the AMF's expectations regarding the criteria to be met by members of decision-making bodies of financial institutions with respect to the integrity and competency expected of them.

In issuing this guideline, the AMF seeks to ensure that financial institutions follow sound and prudent management practices as regards these criteria, particularly by ensuring that individuals appointed to strategic positions within financial institutions are honest and competent.

The fundamental principles and orientations published by certain international organizations<sup>2</sup> clearly explain the need for financial institutions to implement sound practices with respect to integrity and competency criteria. The AMF supports these principles and orientations favouring sound and prudent management practices. Pursuant to the authority<sup>3</sup> conferred upon it under the various sectorial statutes, it is issuing this guideline to explicitly inform financial institutions of its expectations regarding the integrity and competency of members of decision-making bodies.

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<sup>1</sup> For ease of reading, the generic expression "decision-making bodies" will be used to refer to members of boards of directors as well as to senior management (including those in charge of oversight functions).

<sup>2</sup> Basel Committee on Banking Supervision, Bank for International Settlements, Core Principles for Effective Banking Supervision, October 2006.

Basel Committee on Banking Supervision, Bank for International Settlements, Core Principles Methodology, October 2006.

International Association of Insurance Supervisors, Insurance Core Principles 5 - Suitability of Persons, October 2011.

<sup>3</sup> *An Act respecting insurance*, R.S.Q., c. A-32, ss. 325.0.1 and 325.0.2;  
*An Act respecting financial services cooperatives*, R.S.Q., c. C-67.3, s. 565;  
*An Act respecting trust companies and savings companies*, R.S.Q., c. S-29.01, s. 314.1.

## Scope

The guideline governing integrity and competency criteria is intended for insurers of persons (life and health), damage insurers, portfolio management companies controlled by an insurer, mutual insurance associations, financial services cooperatives as well as trust and savings companies, which are governed by the following Acts:

- *An Act respecting insurance*, R.S.Q., c. A-32
- *An Act respecting financial services cooperatives*, R.S.Q., c. C-67.3
- *An Act respecting trust companies and savings companies*, R.S.Q., c. S-29.01.

This guideline applies to financial institutions operating independently as well as to financial institutions operating as part of a financial group.<sup>4</sup> As regards financial services cooperatives and mutual insurance associations that are members of a federation, the standards or policies adopted by the federation should be consistent with—and even converge on—the principles of sound and prudent management prescribed by law and detailed in this guideline.

The generic terms “financial institution” and “institution” refer to all financial entities covered by the scope of this guideline.

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<sup>4</sup> For purposes of this guideline, “financial group” refers to any group of legal persons composed of a parent company (financial institution or holding company) and legal persons affiliated therewith.

## **Coming into effect and updating**

The guideline governing integrity and competency criteria will come into effect on month XX, 2012.

With respect to the legal requirement of institutions to follow sound and prudent management practices, the AMF expects each institution to develop strategies, policies and procedures based on its nature, size, complexity and risk profile, to ensure the adoption of the principles underlying this guideline by (2 years after the date of coming into effect). Where an institution has already implemented such a framework, the AMF may verify whether it enables the institution to satisfy the requirements prescribed by law.

This guideline will be updated based on developments in the criteria for assessing integrity and competency and in light of the AMF's observations in the course of its supervision of financial institutions.

## **Integrity and Competency: foundation for good governance**

Integrity and competency are very broad concepts particularly sought out in those with decision-making power within financial institutions. Generally speaking, the provisions of this guideline<sup>5</sup> apply to the following persons:

- members of the board of directors, including members of the various board committees created for specific purposes;
- members of senior management;
- persons in charge of oversight functions or persons who perform supervisory functions within the institution. Generally speaking, but without limitation, the following functions are contemplated: risk management, compliance, internal audits and actuarial duties.

At a minimum, the AMF expects members of an institution's decision-making bodies to have the necessary attributes to perform their functions:

- integrity, which is demonstrated through the individual's actions and through the conduct of the individual's personal and professional business;
- competency, which is demonstrated through an appropriate level of expertise, professional qualifications and knowledge of, or relevant experience in the financial sector.

The behaviour and integrity of members of decision-making bodies should not leave room for any doubts whatsoever.

It should be noted that as regards the competency of members of the board of directors, the appropriate level of competence may be achieved through a collective set of qualifications.

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<sup>5</sup> As stated above, the generic expression “decision-making bodies” will be used to refer to all of the persons mentioned.

## **Management framework for integrity and competency criteria**

The AMF expects a financial institution to have a policy for assessing the integrity and competency criteria applicable to members of the institution's decision-making bodies.

The assessment policy and related procedures, as well as any amendments thereto, must be in writing and have been approved by the board of directors. The assessment policy should be applied to candidates upon initial assumption of their duties and periodically thereafter so as to ensure their ongoing satisfaction of the established criteria.

Financial institutions should establish appropriate controls allowing them to apply the criteria for assessing integrity and competency and ensure that these internal criteria meet the highest standards.

Ensuring that integrity and competency criteria are met is an intrinsic part of a solid foundation for good governance, sound risk management and compliance. The AMF will base its judgment on compliance with these criteria in order to obtain reasonable assurance that the integrity and competency of the individuals in question are appropriate in light of the responsibilities they are required to assume when performing their respective functions.

## Governance of decision-making bodies

The AMF expects members of decision-making bodies to be honest and competent upon their initial appointment and on an ongoing basis thereafter as long as they continue to perform their functions within the financial institution so that they are able to properly assume their roles and responsibilities.

The very nature of financial institutions, their role in the economy, and the type of risks related to their operations are such that members of their decision-making bodies must have an appropriate level of expertise, specialized qualifications and a good sense of judgment. In addition to these required aptitudes, which are necessary for the sound and prudent management of a financial institution, it is crucial that directors and senior management also perform their functions with integrity and diligence.

## Role of the board of directors

In light of the roles and responsibilities incumbent upon directors under the Governance Guideline,<sup>6</sup> with respect to assessment of integrity and competency criteria, the board or one of its committees<sup>7</sup> should:

- approve the assessment policy and any amendments thereto;
- determine whether the individuals to whom the assessment policy applies have the competence, experience and integrity required to hold their positions within the institution. Although directors are, in fact, being required to perform a self-assessment, the AMF expects those concerned to establish mechanisms ensuring the independence of their judgment;
- be aware of concerns raised by the assessment of the integrity and competency of members of the institution's decision-making bodies. If a member of a decision-making body performs his functions despite certain adverse findings following his assessment, the board of directors should ensure that adequate measures and controls are put into place so as to mitigate any potential risks arising from the assessment. The measures taken should be proportionate to the severity of the failure to satisfy the established criteria.

<sup>6</sup> Autorité des marchés financiers, Governance Guideline, April 2009.

<sup>7</sup> Within the scope of this guideline, a board committee created for purposes of assessing integrity and competency could also perform the assessment based on the policy established by the financial institution.

## Integrity and competency assessment criteria

The AMF expects a financial institution to develop criteria or indicators for assessing the integrity and competency of members of the institution's decision-making bodies.

The most commonly used criteria or indicators for assessing integrity could, in particular, address the following elements:

### 1) *Criminal criteria or indicators*

Members of decision-making bodies should not have a record or evidence demonstrating inappropriate conduct prior to being hired, for example, cases in which they were found guilty of a criminal offence, dishonesty, misappropriation of property or funds, fraud or other penal offence, including money laundering and financing of terrorism.

Based on this indicator, the institution could adapt its judgment, for example, in light of the time elapsed since the irregularity as well as the severity thereof. The conduct and actions of the person subsequent to the irregularity should also be considered.

### 2) *Financial criteria or indicators*

Members of decision-making bodies should not have had any irregular or reproachable conduct regarding their own financial situation or that of an entity by whom they were previously employed and they must not have acted negligently when making decisions. Indicators such as financial difficulties leading to legal proceedings, personal bankruptcy or personal financial difficulties as well as bankruptcy or insolvency proceedings in or in respect of an entity in which the members of the decision-making bodies performed functions are significant indicators for purposes of the assessment policy.

As with the previous indicators, based on this indicator, the institution could adapt its judgment, for example, in light of the time elapsed since the irregularity as well as the severity thereof.

### 3) *Supervisory criteria or indicators*

Members of decision-making bodies should not have been declared by another regulatory authority to be in breach of compliance or to lack integrity in the performance of functions similar to those for which they are being assessed. Reservations expressed by other regulators could relate to withholding of information, submission of incorrect or falsified financial information or statements, or the fact that the person has previously been the subject of corrective actions or interventions by a public authority in connection with the performance of similar functions.

#### **4) *Assessing competency criteria or indicators***

Members of decision-making bodies should have an appropriate level of expertise, professional qualifications and knowledge of, or relevant experience in the financial sector. The institution should have a clear picture of which of these attributes current members of its decision-making bodies possess and identify any deficiencies that should be filled by future directors, members of senior management and those in charge of supervision.

An aptitude and knowledge grid could be created to support planning of training activities for current members. The grid could contain criteria such as experience regarding operations, functional competency; knowledge of the institution's activities; interpersonal skills; aptitude for teamwork; availability; motivation and diversity. Lastly, the various attributes identified by the institution should be ranked by order of importance based on the institution's needs and any deficiencies identified among the existing members of its decision-making bodies.

#### **5) *Other criteria or indicators***

The institution could consider other criteria such as a dispute with a previous employer concerning the improper performance of the person's functions or the failure to comply with internal policies, including a code of conduct, which non-compliance led to the person's dismissal or the imposition of a penalty or disciplinary measures, such as those imposed by a professional association.

## Compliance with the assessment policy and decision-making process

The AMF expects a financial institution to demonstrate initially and on an ongoing basis that the members of its decision-making bodies satisfy the integrity and competency criteria established in the assessment policy and decision-making process.

The financial institution should take the necessary measures to assess integrity and competency criteria at regular intervals.

Such measures could include:

- establishing a regular, appropriate and realistic assessment schedule;
- determining specifically how far back to conduct the assessment for each of the functions contemplated, initially and on an ongoing basis;
- determining which criteria would require independent validation of non-compliance;
- determining the process to be followed in light of the problems that arise when assessing integrity and competency criteria.

## Decision-making process

The AMF expects a financial institution's assessment policy to include a specific decision-making process to facilitate making decisions when a member of the institution's decision-making bodies does not satisfy one or more of the assessment criteria established in the assessment policy.

The financial institution should establish a decision-making process to be applied when an assessment yields adverse findings. The institution should set minimum thresholds for adverse information as well as the type of information to be obtained in order to further analyze the particular case. The decision-making process can be tailored to the unique circumstances of each position or type of institution. The individuals to whom the process applies should be informed about the process.

An adverse finding would not necessarily render a person unsuitable to hold another position within the financial institution. The institution would have to consider each case individually based on the institution's needs and risk tolerance levels. It should be noted that adverse findings regarding an individual's "competence" could be tolerated insofar as mitigating measures are implemented.

However, where a person is found to lack integrity because of adverse findings regarding the person's morality or honesty, such as cases involving fraud or money laundering, the person will not be suitable to hold a position, regardless of the position.

The AMF expects that persons who do not possess integrity and do not have the competence required to assume the decision-making responsibilities for which they were being considered will not be appointed to that position.

A financial institution could decide to entrust all or part of the integrity and competency criteria assessment of candidates to separate entities within the institution or within the institution's group. It could also decide to outsource all or part of the process to an external firm, in which case the outsourcing arrangement would have to comply with the principles set out in the *Outsourcing Risk Management Guideline*.<sup>8</sup>

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<sup>8</sup> Autorité des marchés financiers, *Outsourcing Risk Management Guideline*, December 2010 (update).

## Changes in composition of decision-making bodies

The AMF expects a financial institution to notify it of changes in the functions exercised by members of its decision-making bodies. Similarly, the financial institution should notify the AMF as soon as it has knowledge of circumstances or events likely to have a negative impact on the integrity of members of its decision-making bodies.

Circumstances or events may cause a person who satisfies the integrity and competency criteria to be unable to perform his or her functions temporarily or permanently. In such a case, the AMF expects that person to be replaced within a reasonable period by another person who satisfies the integrity and competency criteria determined in the assessment policy.

In some situations, the newly appointed person may not have all the qualifications allowing him or her to satisfy the assessment policy criteria. It will be the institution's responsibility to ensure that the newly appointed person satisfies the criteria within a reasonable period.

For example, the institution could provide mentoring or additional training or seek help from external resources so as to satisfy the criteria in its assessment policy as soon as possible. Similarly, monitoring or follow-up could be increased or additional resources could be put into place temporarily in order to allow the newly appointed individual to acquire the skills needed to satisfy the competency criteria determined by the institution.

## **Supervision of sound and prudent management practices**

To foster the establishment of sound and prudent management practices within financial institutions, the AMF, acting within the scope of its supervisory activities, intends to assess the degree of compliance with the principles set forth in this guideline in light of the specific attributes of each institution. Consequently, it will examine the effectiveness and relevance of the policies and procedures adopted by financial institutions as well as the quality of supervision and control exercised by their boards of directors.

Integrity and competency criteria assessment practices are constantly evolving. The AMF expects boards of directors of financial institutions to remain current with best practices and to adopt such practices, but to tailor them to their own corporate structure and size.