**FST File No. CU441-2010**
**Decision No. CU441-2010-1**

# FINANCIAL SERVICES TRIBUNAL

**IN THE MATTER OF** the *Credit Unions and Caisses Populaires Act,* S.O. 1994, Chapter 11, ("the Act");

**AND IN THE MATTER OF** Arnstein Community Credit Union Limited;

**AND IN THE MATTER OF** an Order of the Deposit Insurance Corporation of Ontario dated May 18th, 2010 pursuant to subsection 279(1) of the Act;

**AND IN THE MATTER OF** a notice of appeal pursuant to subsection 240.4(2) of the Act.

**BETWEEN**

**ARNSTEIN COMMUNITY CREDIT UNION LIMITED**
**Appellant**

**and**

**DEPOSIT INSURANCE CORPORATION OF ONTARIO**
**Respondent**

**BEFORE:**

Ralph Scane,
Member of the Tribunal and Chair of the Panel

John Solursh,
Chair of the Tribunal and Member of the Panel

David Short,
Member of the Tribunal and of the Panel

**APPEARANCES:**

**For the Appellant:**

Mr. Richard Wozenilek
Ms Patricia Harper

**For the Respondent:**

Mr. Fred Myers
Mr. Daniel Cohen

**DATE HEARD:**
March 29, 2011

## REASONS FOR DECISION

This is an appeal by Arnstein Community Credit Union Limited (Arnstein) from an order of the Deposit Insurance Corporation of Ontario (DICO), dated May 18, 2010 (the Order). That Order, made pursuant to s. 279 (1) (3) of the *Credit Unions and Caisses Populaires Act, 1994, S.O. 1994, c.11, as amended*, (the *Act*), placed Arnstein under supervision by DICO, effective May 27, 2010, until such time as DICO may further order. The appeal to this Tribunal is authorized by sections 240.4 and 279 (6) of the *Act.*

*Background*

Arnstein is a credit union with its principal office in Port Loring, Ontario. It has been in operation for over forty years. DICO is charged under the *Act* with providing insurance against loss of deposits with credit unions, and with carrying out certain regulatory functions over credit unions set out in the *Act.* The stated objects of DICO, as found in s. 261 of the *Act*, include:

> 261. The objects of the Corporation are to,
>
> (a) provide insurance against the loss of part or all of deposits with credit unions;
>
> (b) promote and otherwise contribute to the stability of the credit union sector in Ontario with due regard to the need to allow credit unions to compete effectively while taking reasonable risks;
>
> (c) pursue the objects set out in clauses (a) and (b) for the benefit of persons having deposits with credit unions and in such manner as will minimize the exposure of the Corporation to loss;
>
> …………………….
>
> (e) perform the duties provided under this Act or the regulations or do

> anything the Corporation is required  or authorized to do under this Act or the regulations.

On April 13, 2010, DICO formally initiated the process leading to the Order by a letter to the Chair of the Board of Arnstein, being a Notice of Intention (the Notice) to make an order under s. 279 (1) (3) of the *Act*, making Arnstein subject to supervision, effective April 27, 2010, and offering Arnstein an opportunity to make a written submission to DICO with respect to this proposed order.

Section 279 (1) (3) of the *Act* reads:

> 279 (1)  The Corporation may order a credit union subject to the supervision of the Corporation in any of the following circumstances:
>
> …….
>
> 3. The Corporation, on reasonable grounds, believes that the credit union is conducting its affairs in a way that might be expected to harm the interests of members or depositors or that tends to increase the risk of claims by depositors against the Corporation.

If a credit union is made subject to the supervision of the Corporation, s. 280 of the *Act* gives wide powers to the Corporation to supervise the affairs of the credit union on both operational and policy levels.

*Preliminary Motion*

Prior to the hearing of this appeal, DICO, as required by Rule 43.01 of the *Rules of Practice and Procedure for Proceedings Before the Financial Services Tribunal* (the *Rules*), provided a Record for the appeal, which, as it stated at the appeal, contained all of the documentary material relied upon by DICO in making the Order. Arnstein sought to enlarge this Record by including certain other documents, being communications between Arnstein and DICO prior to the making of the Order, and DPS Rating Reports for 2007, 2008 and 2009 prepared by DICO with respect to Arnstein. Some of these documents were created after the receipt of the Notice of Intention. All of these documents were listed in Appendix D of Arnstein's Notice of Appeal as documents upon which it was relying. At a pre-hearing conference, the Chair directed that the materials attached to the Notice of Appeal be included in a Supplementary Record to be placed before the Tribunal at the Hearing, subject to DICO's right to object to their admissibility. The Chair also directed that an affidavit of Barry G. Brydges, sworn

August 12, 2010 for use by DICO on a motion to stay the order (which motion was subsequently withdrawn), be included in the Supplementary Record, subject to Arnstein's right to object at the hearing. At the Hearing, Arnstein withdrew its objection to the inclusion into the Record of this document.

With respect to the documents sought to be added to the Record by Arnstein, DICO argued that the Record as prepared could not be added to unless Arnstein satisfied the requirements of Rule 43.03. Rule 43 (as interpreted pursuant to a Practice Direction of the Tribunal effective June 15, 2010) reads:

> **43. Appeal Process**
>
> 43.01 [DICO] shall provide a record for an appeal, subject to any specific directions of the Tribunal.
>
> 43.02 Subject to Rule 43.03, no party to an appeal shall enter, file or rely upon any evidence in the appeal that was not before [DICO].
>
> 43.03 The Tribunal may allow new evidence in an appeal provided that the evidence was not reasonably available to the party tendering it at the time [DICO] considered the matter and the evidence is significant to the issues raised in the appeal.

DICO submitted that, once the Record had been prepared and filed, it could not be supplemented unless the tests imposed by Rule 43.03 were met. It argued that Rule 43.02 otherwise precludes consideration of *evidence* not before DICO in making its decision, and that "other extraneous material not considered by DICO is clearly not *evidence*." It further submitted that if Rule 43.02 were to be interpreted so broadly that it encompassed every piece of correspondence between DICO and the appellant, it would open the door to a "vast amount of irrelevant documentation making its way before the Panel and turn the appeal into a form of broader inquiry that is not envisioned by the appeal provisions of the [*Act*]".

The Tribunal allowed Arnstein's motion, and directed that the materials requested by Arnstein be added to the Record.

In the interests of justice, Rule 43 should be interpreted broadly when applied to appeals from what are essentially administrative decisions, made after an investigative process conducted by the decision-maker, albeit after notifying the regulated body of what it proposes to do and why, and giving an opportunity to make submissions as to why the proposed order should not be made. There is no evidence before the Tribunal as to when the original Record, as prepared by DICO, was served on Arnstein, but it was filed with the Registrar of the Tribunal on June 14, 2010. The Notice of Appeal was received at the offices of the Financial Services Commission of Ontario on May 28, 2010. The submissions made by Arnstein in response to the invitation contained in the Notice of Intention were received by DICO on April 23, 2010 and May 6, 2010. Until Arnstein actually received a copy of the Record as filed, it could not be sure of exactly what the Record as prepared by DICO would contain. To argue, as DICO did in its brief filed for the pre-hearing conference held on December 1, 2010, that Arnstein "was provided a full and fair opportunity…to file evidence in this matter prior to the making of a decision by DICO" is, with respect, to avoid the point that the material sought to be added was available to DICO in its files, either at the time it issued its Notice of Intention, or at least when it issued the Order. Where an appellant seeks to make use of such material in order to attempt to make its case, a respondent in DICO's position should not be able to preclude or hamper that attempt by declaring that it made no use of the material in reaching its decision. The appellant is arguing that it *should* have considered this material before reaching its decision, and the Rule should be interpreted to facilitate the making of this argument. If the Tribunal does not have the ability to bring this about under an inherent right to control its procedures, it explicitly is given the right to give directions as to the content of the record by Rule 43.01. As to the argument that this risks a large amount of irrelevant documentation coming before the Tribunal on the appeal, if the professional good sense of counsel does not offer protection, the Tribunal can look after that problem itself if driven to do so.

*Decision on the Appeal*

The appeal is dismissed.

*Reasons for the Decision*

The issue on this appeal is whether DICO erred by issuing the Order. Arnstein submitted that DICO did so err because it imposed the Order:

(a) in violation of the principle of procedural fairness;
(b) absent reasonable grounds to believe that Arnstein was conducting its affairs in a way that might be expected to harm the interests of members or depositors or that tends to increase the risk of claims by depositors against DICO.

The Tribunal will consider these grounds in reverse order.

*The Reasonableness of DICO's Belief*

The Order lists six grounds upon which DICO's decision to place Arnstein under supervision pursuant to s. 279 (1) (3) of the *Act* was based. All of these grounds were included in the Notice. (One ground stated in the Notice was not included among the grounds stated in the Order.) The Tribunal will refer to these grounds, and Arnstein's responses to them, in the sequence in which they appear in the Order.

1. *Arnstein continues to be in material, sustained non-compliance with DICO's By-law No. 5 with respect to credit risk management as evidenced by examination reports dated July 21-25, 2008 and July 15, 2009.*

By s.264 (1) (g) of the *Act*, subject to the approval of the Lieutenant Governor in Council, DICO is entitled to make by-laws "prescribing standards of sound business and financial practices for credit unions". By-law No. 5, "Respecting Standards of Sound Business and Financial Practices" is one of these. The By-law sets out general standards for a number of aspects of a credit union's governance and activities, including "Credit Risk Management". With respect to this aspect, the By-law states

> The fundamental elements of credit risk management include implementing a policy that addresses:
>
> - authorized types and classes of credit instruments
> - limits or prohibitions on credit exposures including concentrations
> - assessment criteria and security requirements for each authorized credit instrument
> - an effective credit assessment system
> - defined and prudent levels of decision making authority for approving credit exposures
> - management of delinquent and impaired loans.

DICO has relied in its order, and in the Record on Appeal, upon a "Third Party Examination Report" based upon an examination conducted in the period July 21-25, 2008 (the 2008 Report), and an "Examination Report", based upon an examination conducted on July 15, 2009 (the 2009 Report), regarding examinations of Arnstein's affairs on behalf of DICO.

In addressing "Credit Risk Management", the Executive Summary of the 2008 Report concluded:

"The credit union does not have effective credit risk management practices as:

The Credit union's risk management policies do not address the significant risks to which the institution is exposed. [A list of six examples is given].
Appropriate and prudent risk management policies, procedures and controls have not been implemented for credit risk management. [Two examples are given]

The credit union did not comply with its credit risk management policy, By-laws and relevant sections of the Act and Regulations."

The 2008 Report itself devotes over seven pages of discussion to its detailed findings on the above points.

The Executive Summary of the 2009 Report states that "[t]he credit union has ineffective credit risk practices". The Report itself devotes over four pages of commentary to this issue.

An undated response to DICO's Notice from Arnstein, received by DICO on April 23, 2010 (the April response) dealt specifically with this ground by stating that Arnstein's management had had extensive discussions with a DICO staff member, and had been told to include its practice within its policy and provide for reports to Arnstein's Board of Directors (the Board). Arnstein alleged that it had done so and asked if that were acceptable and had been told "without any additional comment that it was, as long as it was in the policy. Our credit policies which were more than doubled, now includes what we were advised to include within it and consequently we are at a loss to determine how harm will result to our Members or Depositors or how DICO claims may arise as a result of complying with *"guidance"* provided by a DICO staff member."

On April 29, 2010, DICO wrote to Arnstein stating that it did not consider that Arnstein had supplied evidence to enable it to conclude that Arnstein was in compliance with By-law No. 5, and invited a further submission. Arnstein replied by letter dated May 4, 2010 (the May response). Its response to this particular item read, "[a]s we understand, there were two issues, loans with debt service ratios over 60%, and allowable investments. Amendments were made to our policies concerning both of these issues. Copies of these amended policies were sent to [DICO] some time ago. If there was anything further required please let us know, and we will provide it, if reasonable."

The Tribunal finds that the responses greatly oversimplify the concerns about credit risk discussed at length in the 2008 and 2009 Reports, and consequently, it considers that DICO had good reason to consider that its concerns under this heading had not been fully addressed. Copies of the credit risk policies as they existed at the time the Order was made were not part of the Record, and there was no application to include them in the

Supplementary Record. The Tribunal, therefore, is in no position to assess them against the critiques in the Reports. However, the 2009 Report in particular detailed a sampling of particular loan files examined and what it regarded as material matters of risk found within them. These matters were not addressed in the responses.

> *2. [T]he Credit Union is in contravention of s. 65 of the Regulation which limits investments to 25% of regulatory capital. As at February 28, 2010, it has an investment in mutual funds representing approximately 318% of total regulatory capital;*
>
> *3. The Credit Union is in contravention of subsection 20 (4) of the Regulation which excludes mutual funds as an eligible asset for adequate liquidity and the credit union is including the mutual funds referenced above in its reported liquidity;*

Factually, these grounds stem from an investment, or group of investments made by Arnstein through BMO Harris Private Banking. In the 2009 Report, these investments were addressed under the heading of “Market Risk Management”, concerning which the Report concluded that Arnstein had “ineffective market risk practices”. With respect to this investment, the Report stated:

> The credit union has $2.8 million invested in BMO, Harris Canadian Bond Inc. fund. Mutual funds are not permitted under the credit union’s investment policy. In addition, this investment is in excess of 1.25% of the regulatory capital and deposits of the credit union which is in breach of s. 199.1 of the Act. It is recommended that the credit union either divests itself of the fund or amend its policy to allow for such investment vehicle types and brings the investment into compliance with section 199.1 of the Act.

It appears that the quoted paragraph was partially inaccurate in attributing the totality of this investment to a bond fund. In a subsequent paragraph, the 2009 Report indicates that the “fixed income portion of the fund” totaled $2M, while the “equities portion” totaled “$524k”. In the April response, Arnstein explained that “[w]e invested in 4 BMO Harris Investment Pools (the Money Market, Bond Income, Canadian Income Equity and the Diversified Yield Portfolios).” Nevertheless, Arnstein did not dispute, either in its submissions which predated the Order, or at the hearing, that these investments were in mutual funds, or that the total amount invested through “BMO Harris” exceeded the percentage of regulatory capital invested with a single “person”, BMO Harris, stipulated by the “Regulation.” It also did not dispute that its then policies did not permit investment in mutual funds. As previously mentioned, Arnstein’s investment policies were not placed before the Tribunal, or sought to be so placed.

The “Regulation” referred to is O.Reg. 237/09, made pursuant to the *Act.* S. 65 of that Regulation provides:

> 65. For the purpose of s. 198 of the Act, a credit union shall not directly or indirectly invest, by way of purchase from or loan to one person or more than one person that, to its knowledge are connected persons, more than 25 per cent of the credit union’s regulatory capital.

S. 198 of the *Act* provides:

> 198. A credit union shall invest only in such types of securities or property and on such conditions as are prescribed for its class.

In the April response, Arnstein stated that it did not believe that it was in contravention of s. 65 of the Regulation. It pointed to “Paragraph 199(2)” of the *Act*, which “grants an exception to deposits in a financial institution, or investments in or guaranteed by a federal, provincial or municipal government. The bulk of our investments are in a financial institution, in government bonds or treasury bills, so fall under the exemption of Paragraph 199(2).” This observation was substantially, but more tersely repeated in the May response.

The responses were referring to what is currently s. 199 of the *Act.* That section provides:

> 199. (1) A credit union may directly or indirectly invest, by way of purchase from or loans to a single person ……more than the amount prescribed for in its class only if,
> (a) the investment is in the form of deposits with or loans to,
> (i) a financial institution that is not a credit union or a securities dealer,
> (ii) the Corporation [i.e. DICO], or
> (iii) a prescribed person or entity, or
>
> (b) the investment is in securities issued or guaranteed by the Government of Canada, ..…..by the government of any province in Canada or by any municipality in Canada.

While the Tribunal has some sympathy for a lay Board and management trying to interpret these sections, it is not persuaded that the interpretation by DICO is incorrect, nor was this alleged by Arnstein’s counsel at the hearing, either in the written factum or in oral submissions. Although the status of “BMO Harris” did not appear in the Record or oral submissions before us, it is an easy inference that it is in some way connected to a major chartered bank. However, without more information than was given to the Tribunal, this is not enough to establish that the entity is a "financial institution" as defined by the *Act.* Also, the purchase of units in a pooled fund of investments is not a "deposit', nor are the units purchased the same, for the purposes of the *Act*, as the underlying investments which are held in the pool. Arnstein has failed to persuade the Tribunal that the investments in question were not inconsistent with its own then policies, and not illegal, as DICO alleged.

The allegation in the Order with respect to Regulation 20 (4) also is a reference to *O.Reg. 237/09. S.20* "sets out the requirements for adequate liquidity for class 1 credit unions…". S.20 (4) lists classes of assets that are "eligible assets for adequate liquidity". While this subsection does not expressly *exclude* mutual funds, its terms would not *include* investments in the funds, to the limited extent that they have been described to us. Again, the factual conclusion on this point stated in the Order was not challenged by Arnstein at the hearing. In the April response, Arnstein asserted that, as the purpose of the Regulation is to have sufficient assets available to meet an unexpected draw on its funds, and all of its "investments with BMO can be converted to cash with less than 24 hours notice, how could this not meet the intent of the liquidity regulation?" Again, this submission was substantially repeated in the May response. Assuming for the sake of the argument that the investments in question, or a substantial portion of them at least, were very liquid, the responses do not face up to the fact that, however liquid they may have been, the investments were illegal, and contravened Arnstein's own then policy guidelines.

> *4. The credit union is in contravention of section 55 of the Regulation as it has granted mortgages in excess of 80% of the value of the mortgaged property with no prescribed insurance.*

Again, the Regulation in question is O.Reg. 237/09. This section defines residential mortgage loans as secured on residential property occupied by the borrower where the loan does not exceed 80% of the property value or the loan is insured as described in the section. The 2009 Report noted that the examiners had reviewed a sample of six mortgage loan files, and had discovered that three of these files had a loan to value ratio above 80% (96%, 103% and 93%) with no mortgage insurance purchased, contrary to the Regulation. The examiners concluded that, as the loans did not adhere to the criteria for mortgage loans, they would be considered personal loans and in excess of the personal loan limit of Arnstein.

Arnstein addressed this issue in both the April and May responses. The more succinct May response stated that "these two *(sic)* mortgages were not our normal procedure, but were “damage control” to “protect our investment” as we believe is allowed under By-Law 6, as well as regulation 62. [The intended reference was probably to *s. 62* of *O.Reg.*237/09.] It would be helpful if DICO would advise what they believe should have been done in the circumstances. One of the mortgages has been paid down to below 80%. The other has been formally restructured and payments have begun to pay the principal. An additional allowance has also been made……….[O]ur external auditor reviews ALL loans to ensure the requirements of by-law 6 are adhered to, and this issue will be reviewed with him and on his recommendation, any required adjustments will be made before the year end statements are finalized.”

By-law No. 6 of DICO, *Standards of Sound Business and Financial Practices: Impaired Loans* does contemplate that a credit union may formally restructure loans for economic or legal reasons related to the borrower’s financial difficulties by rewriting the loan to “allow for economic concessions it would not otherwise make.” It lists five examples of such concessions. These do not include lending above 80% on a residential property without mortgage insurance but do include “other concessions which would not be made if the borrower were not in a weakened condition.” S.62 of the *Regulation,* while repeating the 80% mortgage lending limit on improved real estate, does offer relief from this limit, but only where it has acquired real estate “to protect its investment” in a mortgage, and then sells the realty and takes a mortgage back.

Again, the Record does not contain details which would enable the Tribunal to establish whether the circumstances of the mortgages in question might come within the exceptions upon which Arnstein relied in its responses. For example, there is a major difference between restructuring an existing loan to accommodate a borrower in distress by allowing the loan to value percentage to exceed 80%, which might arguably be permissible under by-law No. 6, and making an original uninsured loan in excess of this percentage to help a borrower, which would be illegal. Also, there is nothing in the Record to suggest that the mortgages in question were mortgages taken back on a sale in the circumstances contemplated by s. 62 of the *Regulation*. The issue was not addressed at the hearing. Therefore, the Tribunal cannot conclude that DICO was in error in considering that s. 55 of the *Regulation* had been contravened, as it alleged.

> *5. The credit union is in contravention of DICO’s By-law No. 6 as there has been inadequate identification of impairment resulting in required increases to the allowance for doubtful loans.*

Under the heading, “Asset Quality”, the 2009 Report, which noted that it had sampled for review eight personal and six mortgage loan files, stated that “the credit union has not met the requirements of Bylaw #6”. It noted two mortgages, one impaired by 189 days and one by over six months. It noted that these must be reported on "the Allowance for Doubtful Loans Report", that appraisals should be made to determine the properties most recent value, and that allocations should be made if the value was insufficient to fully secure the mortgage amounts. It also noted a personal loan which was impaired due to a payment reduction which extended its amortization beyond the agreed terms, and accordingly should be added to the Allowance for Doubtful Loans Report. It also noted a line of credit loan impaired for 209 days, which also should be added to the Allowance for Doubtful Loans.

In its May response, Arnstein said, "…our external auditor reviews ALL loans for adherence to bylaw 6, and this issue will be reviewed with him before month end. Any adjustments on his recommendation, will be made before year end financial statements are finalized."

Again, this issue was not examined at the hearing. The examiners who compiled the 2009 Report and DICO appear to have considered that the impairments should be reported as they are recognized as such, rather than await identification on annual year end audit. Again, on the record available to the Tribunal, the Tribunal cannot conclude that DICO was in error in reaching its conclusion.

> *6. The Credit Union is in contravention of s. 92 (1) (5) of the* Act *as certain board members were disqualified from being directors since their loans were more than 90 days in arrears and subsequent approvals were made by the board to regularize these loans.*

This problem was identified in the 2008 Report under the heading of "Asset Quality". The 2008 Report stated, "Three board member loans were contractually delinquent by more than 90 days and were not included as impaired. Per section 92 (1) s.4 of the Act [now s.92 (1) (5)], an individual is disqualified from being a director of a credit union if the individual is more than ninety days in arrears in the payment of a debt owed to the credit union unless the credit union has agreed to extend the time for repayment. The credit union was unaware of this section of the Act…."

The 2009 Report also referred to this incident: "The minutes of the August 1, 2008 board of directors meeting indicated that 4 *(sic)* directors, deemed disqualified for directorship under Section 92 (4) participated in 4 separate votes to extend the times required to repay each of their loans that were identified as contractually delinquent as per By-law No. 6 in the [2008 Report]. Each of the 4 directors were disqualified from voting on these matters or any others at this particular meeting."

In the April response, Arnstein said, “ In this situation we were dealing with a director whose husband was undergoing cancer treatment and as a result of the breadwinner not being able to provide income, the mortgage was approaching arrears. We passed the required motion unanimously, so assumed it had met the Act requirements. Again, with “guidance” from the said DICO staff member, we were advised that the 2/3 majority requirement of board members present for authorizing resolutions to correct the situation was correct. However, on checking the Act the requirement is 2/3 of the board, not 2/3 of the board members present. Our Board immediately corrected this situation at a special meeting for that purpose. At that time there were 2 other board members approaching arrears, so the authorization required was passed for them as well (they are both now up to date). Reduced payments for the first member were passed by Board resolution and they have all been made as agreed. It was a honest mistake, and we cannot change the past.”

S. 92 (1) of the *Act* provides:

> 92. (1) The following individuals are disqualified from being directors of a credit union:
>
> ……………………..
>
> 5. One who is more than 90 days in arrears in the payment of a debt owed to the credit union unless the credit union has agreed to extend the time for repayment.

The Tribunal holds that this subsection of the *Act* requires that the agreement referred to occur before the debt becomes ninety days in arrears.

Here, the Tribunal is faced with conflicting statements of fact that cannot be resolved on the Record, and were not addressed at the hearing. Apart from the disagreement as to the number of directors whose loans are alleged to be ninety days in arrears, there is a clear dispute as to the state of affairs of these loans at the time the Board voted to extend them.

While the 2008 Report is rather ambiguous on this critical issue, the 2009 Report can only be interpreted as stating that at the meeting in question at which the loan extensions were granted, the directors in arrears were already disqualified from voting. Arnstein’s response asserts that, at the time the extensions were voted upon, the three directors to which it referred were only “approaching” arrears. The Tribunal has nothing before it to enable it to resolve the dispute. Accordingly, error not having been established, it must proceed on the basis that the factual allegation in the Order is correct.

The basic ground of appeal is that the test set out in s. 279 (1) (3) of the *Act*, reproduced above, has not been met. The Tribunal holds that the state of affairs which DICO must believe to exist before being entitled to make a supervision order is of a less serious state than would be required if the section had required DICO to believe that Arnstein was conducting its affairs in a way that *would* harm the interests of members or depositors, or that *would* increase the risk of claims. DICO is not required to wait until the interests it is protecting are actually in jeopardy. It is sufficient if it believes that, if it does not take action to improve the present state of affairs, members, depositors and the insurance fund may eventually become at risk.

The *Act* requires that DICO's belief that this state of affairs exists must be based "on reasonable grounds". In *Mugasera v. Canada (Minister of Citizenship and Immigration), [2005] 2 S.C.R. 100, at Para 114,* the Court held that the "'reasonable grounds to believe' evidentiary standard requires something more than mere suspicion, but less than the standard applicable in civil matters of proof on the balance of probabilities…..In essence, reasonable grounds will exist where there is an objective basis for belief which is based upon compelling and credible information."

There are also a number of decisions exploring the meaning of "reasonableness" as used by courts engaged in judicial review of an inferior tribunal's decision. In one such case, *Law Society of New Brunswick v. Ryan, [2003]1 S.C.R. 247, at Para.47,* Iaccobucci J., writing for the Court, said, "[t]he standard of reasonableness basically involves asking "After a somewhat probing examination, can the reasons given, when taken as a whole, support the decision?" Later, at Para. 50, he commented, "[a]pplying the standard of reasonableness gives effect to the legislative intention that a specialized body will have the primary responsibility of deciding the issue according to its own process and for its own reasons." In Para. 55, he noted that "a decision may be reasonable even if this explanation is not one that the reviewing court finds compelling".

While the comments in the previous paragraph are directed to an understanding of the concept of "reasonableness" as employed by superior courts in reviewing decisions of inferior tribunals, the Tribunal believes that they may be employed in understanding the concept of "reasonable grounds" as it appears in s. 279 (1) (3) of the *Act.* DICO has been an insurer of deposits in deposit taking institutions regulated by the Province for some time before regulatory duties were transferred to it, and as such, had developed experience in appraising risks of loss in such institutions for premium rating purposes. Whether the information upon which it bases its decision to act, or not, to exercise its powers under s. 279 (1) (3) of the *Act* is "compelling and credible" must be understood to be information which is assessed by it with that experience in mind. The Tribunal also considers that the time during which DICO made its order is relevant. The financial world was in the aftermath of massive failures or near failures of hitherto respectable financial institutions, and in many quarters, financial regulators were being accused of excessive tolerance in carrying out their duties. DICO would not be unreasonable in concluding that it should move sooner than later if it had concerns.

If DICO were to base its decision on information which is significantly incorrect, or obviously unreliable, it would not be acting "on reasonable grounds", and could be corrected on appeal by the Tribunal. At the hearing, Arnstein challenged the findings of the 2009 Report as unreliable. The basis of this attack was that the two examiners who prepared the 2009 Report spent only six hours "on site" examining Arnstein's records. It was alleged that the examination was "cursory" and "hasty", and that it was therefore unreasonable for DICO to form its belief that the requirements of s. 279 (1) (3) of the *Act* had been met on the basis of this Report.

The Tribunal rejects this argument. As the allegation as to the time spent on site was unchallenged by DICO, the Tribunal proceeds on the basis that this is factually correct. However, it does not follow that the two examiners, while on site, were simply duplicating each other's work. While it has nothing before it to describe what each of the examiners in fact did, the Tribunal notes the possibility that the six hours might translate into up to twelve hours of investigative time. The examination did not purport to be an audit. The text of the Report indicates that the examiners used sampling on occasions, and there is nothing in the material to indicate that the sampling techniques were unreasonable. Also, it is highly unlikely that the examiners embarked on the examination without knowledge of at least the general nature of DICO's concerns as raised by the 2008 Report (upon which the Order also relied), and would therefore have guidance as to areas to examine in order to ascertain whether there had been improvement. Nor does it follow that the "six hours" represents time spent by the examiners in considering their conclusions, or time spent by DICO in considering the Report.

Therefore, the Tribunal rejects the argument that DICO was unreasonable in relying upon the 2009 Report as a principal basis for making its Order, either on the basis that the 2009 Report was "cursory", or that individual findings from the Reports that it cited in the Notice and Order, or a significant number of them, were established to be in error. Given the factual findings upon which it relied, the Tribunal finds that DICO had "reasonable grounds" for arriving at its belief that the requirements of s. 279 (1) (3) of the *Act* were met.

*Violation of the Principle of Procedural Fairness*

Arnstein argues that DICO was in breach of the principle of fairness in the process leading to the making of the Order, and that this breach should lead to the quashing of the Order, independently of the result of the attack on the reasonableness of the Order. The alleged breach is argued to arise out of three circumstances:

(a) DICO placed Arnstein on a "watchlist" in 2007, and did not inform Arnstein of this until 2009;

(b) DICO provided insufficient written reasons for making the Order, and

(c) DICO failed to provide Arnstein with the requisite clarity and direction to know the steps to be taken to avoid Supervision.

In *Baker v. Canada (Minister of Citizenship and Immigration) [1999] 2 S.C.R. 817*, at *Para. 20* of the judgment of L'Heureux- Dubé J., the Court reaffirmed that "[t]he fact that a decision is administrative and affects "the rights, privileges or interests of an individual" is sufficient to trigger the application of the duty of fairness." However, at *Para. 21* of that judgment, the Court pointed out that the existence of the duty does not determine its contents in a given set of circumstances, and that "the concept of procedural fairness is eminently variable and its content is to be decided in the specific context of each case." The Tribunal will consider Arnstein's allegations of unfairness of process in the context of the application of a regulatory tool, a supervision order, by a regulator to a regulated deposit-taking institution.

*(a) The Failure to Advise the Credit Union that it was on a "Watchlist"*

The genesis of this complaint is found at the beginning of the Notice of April 13, 2010. The Notice states, "[a]s you are aware, [Arnstein] has been on DICO's Watchlist under close monitoring since October 7, 2007 due to its failure to meet [the standards of DICO's By-law No. 5]. Our staff has been working with the board and management of [Arnstein] over this time to provide guidance to meet the required standards." In its April Response, Arnstein denied that it was ever advised that it was on a "Watchlist" and stated that it was not aware of this fact. At the hearing, the Tribunal asked DICO if it was aware of any evidence that Arnstein had been so notified, and was advised that counsel did not know of any such evidence. The Tribunal accordingly proceeds on the assumption that Arnstein's allegation that it never received notification that it was on a "watchlist", and was not aware of the fact until receipt of the Notice, is factually correct.

The Tribunal was not made aware of what events in October, 2007 or otherwise may have placed Arnstein on a "watchlist". Also, it was not made aware of any basis, statutory or through DICO's by-laws, for establishing a "watchlist" or for determining any protocols which might follow from placing an institution on such a list. The Tribunal concludes that the "watchlist" in question is simply an internal term used by DICO to flag, for its own purposes, institutions which are causing it significant concern. As such, the Tribunal cannot find any specific requirements regarding notification to institutions causing such concern, until DICO concludes that it is entitled to and should take some regulatory action sanctioned by the *Act.* In such case, any notice requirements stipulated by the *Act* would be triggered, as they were here. The Tribunal concludes that in the circumstance of this type of regulatory activity, no other or greater notice than that set out in the statutory scheme is required. Information may be being received and digested incrementally by the regulator, and concern for the interests to be protected by it increased or alleviated as information is received. The range of concerns within which it decides to make an internal decision to keep a "close eye" on an institution, even though present evidence does not appear to justify taking remedial action under the *Act*, is likely to be very amorphous. Imposing some sort of formal notice requirement when this internal conclusion is reached would be impractical in day to day regulation. For one thing, such a requirement might be held to require another set of articulated reasons for reaching this level of concern, and another opportunity for formal contention of the conclusion.

*(b) The Inadequacy of the Reasons for DICO's Decision*

Under this heading, Arnstein challenges not only the reasons given for making the Order, but reasons given by the Risk Management Committee of the Board of Directors of DICO, in a letter to Arnstein dated April 5, 2010. This letter responded to a request from Arnstein (which was not in the record before the Tribunal) which challenged and requested a review of the 2009 Report. That Committee stated that it had reviewed Arnstein's submissions and "has concluded that there was no evidence provided by [Arnstein] that would support a conclusion that the examination findings at the time of the examination were not factual. As a result of the review, the examination findings as reported to the Board of [Arnstein] and [Arnstein's] risk rating for the purposes of its premium calculation remain unchanged." As DICO points out in its Factum, this finding of the Risk Management Committee is not the subject of this appeal, and the Tribunal is not aware of any statutory provision which would make it subject to appeal to the Tribunal. The issue before the Tribunal under this ground of appeal must be the adequacy of the reasons given by DICO for making the Order.

The Tribunal holds that the duty of fairness does require that reasons for the making of the Order be supplied. The existence of a statutory right of appeal to this Tribunal indicates that Arnstein is entitled to have a reasonable understanding of the case against it, in order to construct its appeal. However, the required nature of the reasons is variable with the specific context of the case, as is the more general principle itself. In *Baker, supra,* L'Heureux-Dubé J. examined at length the nature of the duty to give reasons including the case of administrative orders, and referred, at *Para.44*, to the "flexibility that is necessary…when courts evaluate the requirements of the duty of fairness with recognition of the day-to-day realities of administrative agencies and the many ways in which the values underlying the principles of procedural fairness can be assured."

In this case, the Tribunal finds that the reasons supplied to Arnstein met the requirements of the duty. Both the Notice and the Order referred to the 2008 and 2009 Reports, and highlighted the particular deficiencies which led DICO to make the Order. It is true that they did not explicitly trace the link between the facts to which they referred and the statutory ground for making the Order, but in the Tribunal's view, the inference is obvious. The facts cumulatively supplied reasonable grounds for DICO to conclude that the threshold of belief set by s. 279 (1) (3) of the *Act* had been met. It was not necessary for DICO to argue this conclusion in the Order. The Reports themselves, which must be seen as part of the reasons, not only elaborated the statements of fact in the Notice and Order, but often commented on why the findings were a cause for concern. The Tribunal cannot accept that Arnstein's Board and management did not have the means of being fully aware of DICO's concerns which led to the Order, whether they accepted these concerns as valid or not.

*(c) Failure to Supply Requisite Clarity and Direction*

In its Factum, Arnstein submitted that, prior to the making of the Order, it "repeatedly attempted to explain to DICO through formal submissions and correspondence why it disputed DICO's findings of non-compliance and propose alternatives to Supervision of [Arnstein]." It further submitted that "DICO failed to respond to these inquiries in a manner that would enable Arnstein to know what steps it could take to avoid supervision." Certainly complaints of this nature may be found in submissions and correspondence to DICO from Arnstein contained in the Record. There are also references, both in Arnstein's submissions and correspondence, and in DICO's Notice, to attempts by staff of DICO and Arnstein to resolve problems. The material gives little help to the Tribunal in attempting to evaluate these interchanges.

However, whatever the degree of co-operation, or lack of it, between Arnstein and DICO in attempting to work out the problems which led to the making of the Order, Arnstein has not persuaded the Tribunal that DICO was under any legal duty to carry out such an educational effort. No authority has been cited to us to suggest that the failure to guide a regulated institution to a means to avoid a regulatory direction may be a violation of the general principle of procedural fairness which would vitiate that direction. The Tribunal is unwilling to invent such a duty, if none already exists. In the Tribunal's view, the imposition of such a duty, at least in this case, would have a paralyzing effect on the regulatory process. Doubtless some educational time spent with a co-operating regulated institution would be, in many cases, an efficient way to shepherd an institution back into what the regulator regards as good practices, but the regulator must be the judge of the likely fruitfulness of such an approach in any given case, and of its ability to assign resources to such an effort. Otherwise, once it determined that there was cause for concern, it could not move until it had given warning, given advice, and determined how long it should wait to see if the advice would be taken before taking any formal action. This is a burden which should not lightly be imposed on a regulator one of whose primary responsibilities is protecting public deposits.

Further, the Tribunal does not believe that Arnstein was much prejudiced, if at all, by DICO's alleged failings in this regard. The 2008 and 2009 Reports are replete with explanations of shortfalls as seen by the examiners. There is no lack of guidance in them. Until the Order was made, the Board of Arnstein had the responsibility of determining the steps to be taken to make it a compliant institution, and whether to take those steps, and had at least the Reports to guide it. It could not shift that responsibility to DICO by asking what it should do. DICO assumes that responsibility only when it exercises its regulatory powers, such as making the supervisory order in question here, in the context of its objects as set out in s. 261 of the *Act*.

The Appeal is dismissed.

**DATED** at Toronto, Ontario, this 31st day of May, 2011

"Ralph Scane"
Ralph Scane
Member of the Tribunal and Chair of the Panel

"John Solursh"
John Solursh
Chair of the Tribunal and Member of the Panel

"David A. Short"
David A. Short
Member of the Tribunal and of the Panel