



Ontario

Deposit Insurance
Corporation of Ontario

Société ontarienne
d'assurance-dépôts

Director's Handbook

Summer 2009



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[Ce document est également disponible en français.](#)

Introduction

The position of director of a **credit union** is both challenging and rewarding. As a director, you are responsible for ensuring that your credit union continues to meet the financial service needs of its members. The members of your credit union are relying on you and the other directors to guide the organization into the future.

The Deposit Insurance Corporation of Ontario (DICO) has developed this Director's Handbook to help you fulfill your role as a director. The Handbook describes your duties and responsibilities, and gives you the basic information you need to carry them out. It also outlines risk management practices to help build a strong future for all Ontario credit unions.

The Handbook summarizes:

- your duties and responsibilities as a credit union director;
- how to do your job as a director;
- tools and programs to help you;
- the Ontario credit union and **caisse populaire** sector;
- the legal framework of the sector;
- how your credit union can manage risk by complying with DICO By-law #5 (Standards of Sound Business and Financial Practices) and implementing an Enterprise Risk Management Process;
- DICO authority.

For more information on your role as a director, DICO's programs, or risk management, please refer to our web site or call your Regional Manager or Insurance and Risk Management at DICO's toll-free help-line:

www.dico.com
Email: info@dico.com
1-800-268-6653

Duties and Responsibilities of Directors

The duties and responsibilities of directors are set out in the *Credit Unions and Caisses Populaires Act (the Act)* and the **Regulations** under the Act, and in DICO By-law #5 (Standards of Sound Business and Financial Practices). If you are unsure of your duties, you should seek clarification from the Chair of the Board, the credit union's solicitor, the Financial Services Commission of Ontario (FSCO), your credit union's league, Central 1, association or your personal solicitor.

As outlined in the Act, as an individual director, you are responsible to:

- carry out your job honestly, in good faith, and in the best interests of the credit union;
- exercise care, diligence and the skill that a reasonably prudent person would exercise in comparable circumstances in fulfilling your responsibilities;
- hold in strict confidence all transactions by members and the organization, except where permitted by law;
- disclose to the Board when there may be a conflict between your personal interest and the interests of the credit union and, in most cases, being absent from the vote on material contracts in which you have a personal interest; and
- comply with all the relevant sections of the Act, Regulations, DICO by-laws, articles and by-laws of the credit union and other applicable laws and statutes.

The Board of directors is responsible for directing the management of the business and affairs of the credit union. In undertaking its responsibilities, the Board or any director shall not directly manage or be involved in the day-to-day activities of the credit union. The Board of directors must meet at least quarterly to monitor and assess the adequacy of management's activities in achieving the business objectives of the credit union and compliance to the credit union's risk management policies.

The Board's responsibilities include:

- establishing the organization's business objectives;
- reviewing and approving the organization's policies and annual business plan;
- ensuring that qualified and competent management is appointed to implement appropriate risk measurement techniques and risk management procedures;
- reviewing and approving the annual internal and external audit plans;
- reviewing reports of the Audit Committee and ensuring that all recommendations are appropriately addressed;
- monitoring the performance of the credit union to ensure adherence to policy and the annual business plan; and
- overseeing community relations and protecting members' rights.

The Board of directors delegates to the management of the credit union responsibility for day-to-day operations, including:

- developing and recommending policies and the annual business plan for approval by the Board;
- communicating policies and the business plan to staff and volunteers;
- implementing policies and the business plan;
- employing and training qualified and competent staff;
- measuring the level of risk in the operations of the credit union, using an appropriate reporting system; and
- managing risk in the credit union's operations through appropriate procedures and corrective action.

The Board of directors may not delegate the following responsibilities:

- filling vacancies on the Board or the Audit Committee;
- appointing or removing an officer or director of the credit union;
- appointing signing officers;
- adopting, amending or repealing by-laws;
- issuing securities except in the manner and on the terms authorized by the Board;
- authorizing the payment of a commission upon the sale of shares;
- purchasing, redeeming or otherwise acquiring shares issued by the credit union;
- approving the financial statements;
- authorizing the purchase, sale, lease, exchange or other disposition of material assets;
- declaring dividends or patronage returns; and
- expelling a member.

Committees of the Board

The board of directors is required to establish an **Audit Committee** composed of at least three directors appointed by the board. The Audit Committee liaises with internal and external auditors and makes recommendations on the effectiveness of the internal control environment within the credit union. The Audit Committee must meet at least quarterly. Further requirements of the Audit Committee can be found in Section 27 of the Regulations and the Audit Committee Handbook published by DICO and available on our website at www.dico.com.

The **board of directors** may also establish and receive assistance from various other optional committees to assist it in fulfilling its responsibilities. These include, but are not limited to: Executive Committee; Corporate Governance Committee; Risk Management Committee; Asset Liability Management Committee; Credit Committee; Finance and Budget Committee; Long-Range Planning Committee; Human Resources Committee; and/or Nominating Committee.

Understanding the Differences: *Board and Staff*

The following summary illustrates the primary differences between Board members and staff members.

| Board Members | Staff Members |
|--|--|
| are volunteers | are paid |
| are elected and/or appointed | are hired |
| set policy | recommend, implement and operate within policy |
| assign authority to staff | receive authority to operate |
| are oriented to setting direction | focus on the daily work and administration |
| are advocates | provide support information, statistics and background documentation |
| oversee operational results and the business plans | establish operational targets, budgets and activities |
| oversee compliance with policy and legislation | establish internal control processes |

Understanding “Lines of Authority”

Chain of Command

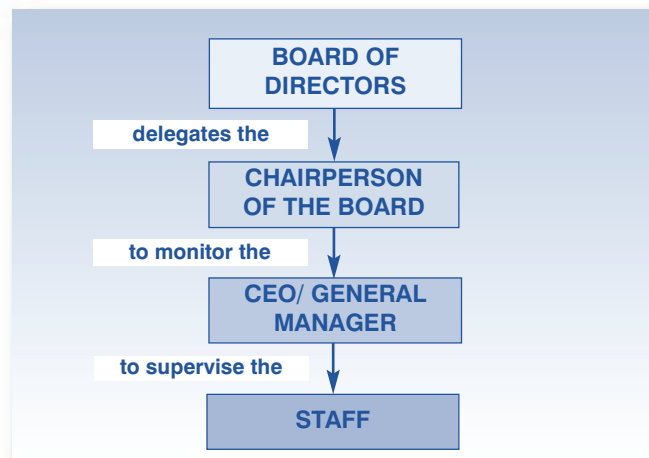
The understanding behind the "line of authority" is that **a person should have only one supervisor**. If more than one person directs the staff, confusion can quickly follow. A variety of policy interpretations and job assignments may very easily place the members of the team in conflict.

The Board’s Chair should be the only one to direct the CEO/General Manager.

Board members should not direct staff members

The performance of the staff is the responsibility of the CEO/General Manager, who also has the responsibility for hiring and terminating, in addition to directing staff. This does not preclude the possibility of Board involvement where an appeal or grievance could not be resolved at the staff level.

Following the lines of authority helps to preserve the lines of authority, accountability and communication.



Your Job as Director

As a director, you are providing an important service to your credit union, and to your fellow members. Your members have entrusted you to oversee the organization. The following are some steps you can follow to best carry out your duties:

- undertake appropriate training requirements as established by the credit union;
- regularly attend board meetings, and prepare for them by reviewing all material provided by management;
- actively participate at board meetings and question management so that you fully understand their reports and actions. If you feel you are not receiving enough information to make an informed decision, ask for more, and be prepared to defer a decision until you are provided with sufficient information prior to the meeting;
- ensure that the best interests of the credit union are considered in all board decisions;
- ensure management has developed, and the board has approved, all the policies and procedures required under the Act and DICO **By-law #5 - Standards of Sound Business and Financial Practices**;
- ensure that an appropriate Enterprise Risk Management framework has been established based on size and complexity of the credit union;
- fully understand the limits imposed on the credit union's business powers under the Act, the Regulations, and the credit union's by-laws, articles and policies, and ensure the board does not exceed those limits;
- ensure controversial decisions involving conflicts of interest are carefully documented;
- keep abreast of legal actions taken by or against the credit union;
- review examination reports and other reports prepared by external parties, league reports and external auditors' reports to identify and correct weaknesses in the operation of the credit union, and to ensure the best possible performance (for a list of reports to the board, see page 23); and
- develop a common view among board members before making a public comment regarding controversial issues that concern the credit union.

Protecting Yourself from Liability

Following the steps listed above, and acting honestly and in the best interest of your credit union, will help you to fulfill your duties under the Act and DICO By-law #5.

Every director of a credit union has fulfilled their duty of compliance with the Act, the regulations, the articles and by-laws of the credit union if they exercised the degree of care, diligence and skill that a reasonably **prudent person** would exercise in comparable circumstances. You should also ensure that your name is recorded in the minutes if you either abstain or vote against a motion or resolution of the Board, keep notes of all meetings and that minutes of meetings accurately reflect discussions held.

If you fail to carry out your duties or if you take unlawful actions that harm the credit union, you may be dismissed from the board or expelled from the credit union. You are also at risk of being held personally liable to your credit union for damages and even receiving a fine or imprisonment if you have been found guilty of an offense under the Act.

You may wish to mitigate your legal liability by obtaining **director's liability insurance** (Refer to Sections 152 to 156 of the Act). Contact your league, Central 1, association or insurance carrier for more information in this regard.

Help for Directors

From DICO

In addition to this Handbook, DICO has developed tools to help directors fulfill their duties and responsibilities. The following tools are provided free of charge to you and your credit union and are available on DICO's web site (www.dico.com):

- **Self-Assessment Workbooks** are tools which are designed to help credit union boards and management assess the effectiveness of the credit union's business and financial practices and compliance to DICO By-law #5. Sample workbooks have been developed which may be modified as necessary to meet needs of individual credit unions. Separate workbooks have been developed for the board and management.
- The **Sound Business and Financial Practices Reference Manual** assists the board and management in complying with DICO By-law #5. It describes the scope and content of board policies and procedures, techniques for measuring risk, and strategies to improve performance and reduce risk.
- The **Audit Committee Handbook** assists directors in understanding their responsibilities and duties when appointed as members of the credit union's Audit Committee. It provides additional information on the duties of the Audit Committee outlined in Section 27 of the Regulations.

From the Sector

Other organizations in the credit union and caisse populaire sector also offer training and assistance to directors:

- **CUSource.** The **Credit Union Directors Achievement (CUDA) Program** is a nationally recognized program of education and orientation specifically tailored for credit union directors. The CUDA® Program and courses are delivered in each province by CUSOURCE Credit Union Knowledge Network. CUIC Inc., doing business as CUSOURCE Credit Union Knowledge Network, is a wholly own subsidiary of Credit Union Central of Canada. CUSOURCE Credit Union Knowledge Network is the home of learning, knowledge sharing, career management and strategic employee and director development for the Canadian credit union sector. The Ontario regional office is located in Toronto and can be reached by calling 1-800-267-2842. See www.cusource.ca.

The three-level CUDA program is a blend of online courses and facilitated workshops and includes a business simulation that gives directors an opportunity to apply their governance skills. Topics such as roles and responsibilities, the legal environment, financial statements, and monitoring performance help to orient new directors in particular to their role; other courses expose directors to topical issues and build on foundational governance knowledge and skills. These topics include strategic planning, the role of the Audit Committee, management recruitment, leadership succession, enterprise risk management, financial red flags, building the board, and many more. After completing the program, directors may write an exam to become Accredited Canadian Credit Union Directors.

- **Credit Union Directors of Ontario (CUDO)** organizes an annual Directors' Forum, which focuses on current topics and issues of interest to credit union directors.
- **Central 1** offers various courses designed for credit union directors and committee members. Topics include roles and responsibilities, legislation, financial management and analysis, strategic planning, credit and audit.
- **L'Alliance des Caisses populaires de l'Ontario Limitée** offers an annual one day training session to new members of the board to review the roles and responsibilities of directors and committee members.
- **La Fédération des Caisses populaires de l'Ontario Inc.** offers various courses on topics of interest to directors, general managers and staff.

Ontario Credit Union and Caisse Populaire Sector

Credit unions provide a wide range of financial services to individuals, small and medium-sized businesses, corporations and institutions throughout Ontario. Credit unions are formed among people with a common bond, such as a particular community, language, religious or ethnic group or place of work. As cooperative organizations, credit unions are wholly owned by their members, and are governed by boards of directors selected from the membership. Unlike banks, which are federally regulated, credit unions are provincially licensed and deposits are insured by DICO.

The following organizations and institutions service, regulate or assist Ontario credit unions:

- **Financial Services Commission of Ontario (FSCO):** FSCO, a provincial government commission, regulates financial institutions that are provincially incorporated, such as credit unions. FSCO is primarily responsible for market conduct regulations surrounding the formation and corporate practices of credit unions. FSCO approves the incorporation and amalgamations of credit unions and monitors compliance to prescribed business powers and responsibilities.
- **Deposit Insurance Corporation of Ontario (DICO):** DICO is a provincial government agency. It is responsible to the Ontario provincial government for protecting depositors of Ontario's credit unions from loss of eligible deposits. Deposit insurance is part of a comprehensive depositor protection program for all Ontario credit unions which is supported by provincial legislation. As part of its mandate, DICO is also responsible for ensuring compliance with all solvency regulations under the Act, including prescribed requirements for capital, liquidity, lending and investments of the credit union and compliance with sound business and financial practices. In fulfilling these responsibilities, DICO performs on-going risk assessment analysis and conducts regular on-site examinations of the risk management and compliance practices of credit unions.
- **Leagues:** Some credit unions are affiliated with a provincial league. The leagues are provincially incorporated associations that act as central bankers and trade associations for their members. They also provide members with access to liquidity funding, training, consulting and other services. The two leagues in Ontario are the L'Alliance des Caisses populaires de l'Ontario Limitée (L'Alliance) and La Fédération des Caisses populaires de l'Ontario Inc. (La Fédération).

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- **Central 1 Credit Union of Ontario:** The majority of Ontario credit unions are members of Central 1 Credit Union which provides similar services as the Leagues.
 - **Association of Credit Unions of Ontario** (the “Association”): A trade association that represents and lobbies to regulators and other stakeholders on behalf of a group of credit unions not affiliated with a league.
 - **Credit Union Central of Canada (CUCC):** CUCC is a national affiliation of provincial leagues and co-operatives. CUCC manages the national liquidity system, acts as advocate for the sector with the federal government and is the national trade association.
 - **La Confédération Desjardins:** La Confédération is the league of Québec caisses populaires. It is also affiliated with La Fédération in Ontario.
 - **Credit Union Insurance Services (CUIS):** CUIS provides insurance services and products, such as property and casualty insurance, to Ontario credit unions. It is a joint venture of the Co-operators Insurance Group and the Credit Union Members’ Insurance Societies (CUMIS).
 - The **Credit Union Bonding Program (TCUBP):** TCUBP provides bonding insurance to Ontario credit unions. It is a joint venture of the Co-operators Insurance Group and The CUMIS Group Limited.
 - **External Auditors:** Professional accountants who express an opinion on the financial statements of the credit union and perform other audit or accounting functions.
 - **Other Organizations:** Various provincial or national organizations represent various groups of credit unions or credit union professionals, such as Credit Union Directors of Ontario (CUDO); the Ontario Association of Small Credit Unions; and the Advisory Council of Smaller Credit Unions established by Central 1 for their members.

Legal Framework of the Ontario Sector

Ontario credit unions are regulated primarily by the Act and Regulations proclaimed under the Act. The powers of credit unions are also governed by DICO's by-laws, as well as each credit union's by-laws and articles of incorporation. Other provincial and federal statutes and common law create additional legal rights and obligations. The various parts of the legal framework are briefly discussed below.

The Ministry of Finance is primarily responsible for establishing policy and developing supporting legislation. It regularly obtains and solicits input on policy issues and recommends changes to legislation to meet the changing needs of the province, consumers, industry and related stakeholders.

FSCO is primarily responsible for market conduct regulation surrounding prescribed corporate and business practices. DICO is primarily responsible for providing a deposit insurance protection program and for assessing the adequacy of risk management practices and compliance related requirements set out in the Act and Regulations.

For a list of key sections of the Act and the Regulations please refer to Pages 26 and 27.

DICO By-laws

Three DICO by-laws directly affect Ontario credit unions.

- **By-law #3** prescribes deposit insurance coverage and information on advertising of deposit insurance coverage by credit unions.
- **By-law #5** prescribes standards of sound business and financial practices for credit unions, including policies and procedures for risk management. It defines the roles of the board of directors and management in implementing sound business and financial practices.
- **By-law #6** prescribes guidelines for the reporting and accounting of impaired loans, according to Section 3025 of the Handbook of the Canadian Institute of Chartered Accountants. This Handbook set out the generally accepted accounting principles (GAAP) which all public corporations, including credit unions, are required to follow. An Application Guide to By-law #6 provides detailed guidance on impaired loans including the specific and non-specific loan loss allowance.

Credit Union By-laws, Articles and Lending and Investment Powers

The articles of incorporation and by-laws of a credit union set out much of what a credit union can and cannot do, including who can become a member, how the credit union's profits may be distributed, and the types of loans the credit union can offer. Directors must ensure that the credit union and the board comply with the by-laws and the articles. The Act and Regulations outline the lending and investment powers of a credit union. If a credit union or its staff contravenes these designated powers, the credit union's lending and investment powers may be restricted or revoked by DICO.

Other Legislation

The board of directors may be held responsible for any actions taken by a credit union which does not comply with other legislation, including:

- the **Personal Information Protection and Electronics Documents Act (PIPEDA)** which requires the credit union to appoint a privacy officer, observe privacy legislation surrounding the collection, use and disclosure of personal information of its members and employees and information obtained in its normal course of business;
- the **Consumer Reporting Act**, which ensures that proper information is communicated to members about the credit union's products and services;
- the **Proceeds of Crime (Money Laundering) and Terrorist Financing Act** which requires the credit union to appoint a compliance officer, implement a compliance regime for identifying and reporting certain large and suspicious financial transactions;
- the **Bankruptcy and Insolvency Act**, which requires the credit union to observe the rights of debtors and creditors in dealing with the assets of a bankrupt individual, and provincial creditor protection legislation;
- the **Ontario Human Rights Code**, which deals with discrimination in the treatment of employees and in hiring;
- the **Pay Equity Act**, which ensures that staff and officers receive equitable compensation;
- the **Employers Health Tax Act**, which requires the credit union to remit health taxes;
- the **Income Tax Act, Canada Pension Plan and Employment Insurance Act**, which require the credit union to remit income taxes and Canada Pension Plan and Employment Insurance premiums;
- the **Employment Standards Act**, which ensures that the credit union meets standards of fair employment;
- the **Ontario Health and Safety Act**, which sets out employers duties regarding the health and safety of employees within the workplace; and
- **employment law**, which governs cases such as wrongful dismissal, or the lack of a proper notice period.

Managing Your Credit Union's Risk

Credit unions are in the business of accepting and managing risk as a normal part of doing business each day. Accepting member deposits, making loans to members, determining savings and lending interest rates, making investment decisions, all involve choices and hence risk.

Your responsibility is to ensure these risks are managed and that the credit union obtains a reasonable return on its investments that covers expenses and provides a satisfactory return for members. Your credit union cannot avoid financial and other types of risk, but the board and management can effectively manage and reduce risk through sound risk management practices.

All credit unions are required to comply with DICO By-law #5. This by-law was created specifically to help credit unions manage key business and financial risks. The by-law establishes the minimum requirements for managing specific risk areas and includes four broad tasks:

- **Setting and Reviewing Policies:** Each credit union is required to establish policies that put limits on the type and amount of business risk it will assume. Management assists in this process by developing and recommending changes to policies as necessary to reflect changes in the business and risk environment of the credit union and submits these for review and approval by the board of directors.. Directors are expected to act prudently by exercising careful and responsible judgment to ensure policies continue to address the material risks to which the credit union is exposed and that comply with the Act, Regulations and DICO's standards of sound business and financial practices.
- **Planning:** The credit union conducts an annual planning process to produce a business plan. The plan sets out goals and objectives for the organization, including targets for performance and risk tolerances that will ensure its long-term success. The annual plan and budget are reviewed and approved by the board of directors.
- **Measuring Risk:** The credit union uses a reporting system to measure performance and business risk and compare results to the business plan and to historical trends. The reporting system allows the organization to evaluate its performance and deal with variances from the plan. These results and trends should be reviewed and discussed by the board of directors who should confirm the appropriateness of initiatives and plans to address any material variations.
- **Managing Risk:** The credit union manages its risk by following procedures that require corrective action in the case of high risk or poor performance. Resolutions and initiatives to correct any material deficiencies should be monitored by the board.

Enterprise Risk Management

In addition to the minimum requirements of By-law #5, credit unions are also expected to establish an appropriate Enterprise Risk Management framework that encompasses all potential risk areas that a credit union may face including operational, legal and reputation risk.

Enterprise Risk Management (ERM) is a process that:

- helps the credit union identify and manage all material internal and external risks that may affect its performance, reputation and viability;
- provides the basis for the credit union's decision making processes from the development of its strategy to its daily operations, reporting and compliance routines;
- seeks to optimize risk management by balancing the cost of risk with the cost of control for all aspects of the credit union's potential risk areas to ensure organizational objectives are met.

Ideally, the process should involve staff, management and the board in order to identify all the credit union's risk areas and risk tolerances. By implementing an ERM process, the board is able to focus on major risks and risk trends that can indicate future problems if new strategies are not implemented. An effective ERM process should be tested regularly by the Board to ensure that it is sufficiently robust and that management and the Board use consistent parameters.

Further information on ERM is available on our web site.

By-law #5: Standards of Sound Business and Financial Practices

DICO By-law #5 sets out seven standards of sound business and financial practices. The standards outline the key elements that each credit union should consider and address when developing policy and procedures. The standards, and their importance to you as a member of the Board, are outlined below. Further guidance on the standards is outlined in the sample Self Assessment Workbooks and the Sound Business and Financial Practices Reference Manual (the Reference Manual). The Reference Manual also provides guidance on the scope and content for Board policies and procedures, techniques to measure risk, and strategies to improve performance and reduce risk.

1. Governance

The Board of directors is ultimately responsible for ensuring that the credit union is operated in a safe and prudent manner and for ensuring adherence to the standards of sound business and financial practices. In fulfilling its responsibilities, the Board of directors should be guided by co-operative principles and ensure that the credit union operates on a co-operative basis. Management is responsible to ensure that the credit union applies the processes, procedures and controls necessary to prudently manage the risk and to provide the Board of directors with timely, relevant, accurate and complete information to enable it to assess that delegated responsibilities are being discharged effectively.

1(a) Governance: Board of Directors

It is a sound business and financial practice that the Board of directors of a credit union understands its responsibilities, exercises independent judgment, addresses the material risks to which the credit union is exposed, and regularly evaluates its own effectiveness and that of management.

The care, diligence, skill and prudence exhibited by a credit union's directors have a critical influence on the credit union's viability, safety and soundness, its ability to execute its business strategy and to achieve its business objectives and to promote confidence on the part of members and depositors. The fundamental elements of good governance for the Board of directors are:

- establishing appropriate and prudent risk management policies for each of the standards and obtaining reasonable assurance that the credit union is adhering to its risk management policies for significant risks;
- establishing the responsibilities, accountability and authority of Board committees;
- establishing standards of business conduct and ethical behaviour;
- appointing appropriately skilled and experienced management to implement the Board's objectives;

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- establishing the business objectives of the credit union consistent with cooperative principles and approving the credit union's business strategy and business plans;
 - evaluating the credit union's actual operating and financial results against business plans;
 - evaluating the effectiveness of management.

1(b) Governance: Management

It is a sound business and financial practice for management of a credit union to ensure that the credit union has on-going, appropriate and effective processes for risk management and strategic management.

Management is responsible to meet the Board of directors' business objectives, control the day to day activities of the credit union and to implement the Board-approved risk management policies. The fundamental elements of good governance for management are:

- implementing appropriate and prudent risk management policies, procedures and controls for each of the standards;
- developing and implementing an appropriate and prudent business strategy and business plans;
- providing the Board of directors with timely, relevant, accurate reports on the implementation of the credit union's business strategy and business plans and any material risk that may affect business objectives.

2. Capital Management

Credit unions need **capital**. Capital creates a cushion to protect your credit union during periods of economic distress and help it remain viable. It also enables the credit union to pursue new business opportunities, and to be more competitive. The Board must confirm how much capital your credit union needs. The amount will vary depending on the business environment in which the credit union operates and the degree of risk it is willing to assume.

It is a sound business and financial practice for a credit union to have appropriate and prudent policies and controls to manage the capital risk of the credit union.

The fundamental elements of capital management include implementing a policy that addresses:

- the quantity, quality and composition of capital needed that reflect the inherent risks of the credit union and to support the current and planned operations;
- distribution of dividends and redemptions of capital instruments to members.

3. Credit Risk Management

Careful management of **credit risk** can minimize the credit union's risk while securing reasonable returns. The stability of your credit union depends on sound credit risk management. Financial institutions may encounter serious financial losses if they do not ensure that their loan portfolios are adequately diversified or they grant too many higher risk loans.

It is a sound business and financial practice for a credit union to have appropriate and prudent policies, procedures and controls to manage the on- and off-balance sheet credit risk of the credit union.

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 concentration;
- 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

Expectations for prudent credit risk management are outlined in DICO's "Guidance Note: Lending" which is available on our website.

4. Operational Management

Operational risk is inherent in all operations of a credit union, and encompasses many areas of its day to day activities. The most common sources of operational risk include people or employee risk, process risk, technology risk and outsourcing risk. Operational risk management (including appropriate internal controls, segregation of duties and effective internal audit function), help establish preventive measures by your credit union's management to limit the risk of error, fraud, theft or misappropriation by employees or external suppliers.

It is a sound business and financial practice for a credit union to have appropriate and prudent policies, procedures and controls to manage the operational risk of the credit union.

The fundamental elements of operational risk management include implementing a policy that addresses:

- defined and prudent levels of decision-making authority;
- the security and operation of a management information system;
- technology development and maintenance;
- safeguarding of the credit union's premises, assets and records of financial and other key information;
- disaster recovery and business continuity plans;
- outsourcing of services;
- monitoring controls.

5. Market Risk Management

The Board and management of your credit union must think carefully about the decisions involved in managing its investments in financial instruments and other assets. The aim is to avoid undue risk and to secure a reasonable return on investments.

It is a sound business and financial practice for a credit union to have appropriate and prudent policies, procedures and controls to manage the on- and off-balance sheet market risk of the credit union.

The fundamental elements of market risk management include implementing a policy that addresses:

- authorized types, limits and concentration of investments, other financial instruments, and assets;
- defined and prudent levels of decision-making authority;
- identifying, measuring, providing for and recording market impairments

Class 1 credit unions may only purchase investments as prescribed in the Regulations.

Expectations for prudent market risk management for Class 2 credit unions are outlined in DICO's "Guidance Note: Investments" which is available on our website.

6. Structural Risk Management

Structural risk is the risk related to changes in interest rates and the mix of assets and liabilities on the balance sheet. Part IX of the Regulations provides further information and requirements with respect to interest rate risk management. The aim is to manage these risks in a way that allows a credit union to meet the needs of its members while contributing adequately to earnings.

It is a sound business and financial practice for a credit union to have appropriate and prudent policies, procedures and controls to manage the on-and off balance sheet structural risk of the credit union.

The fundamental elements of structural risk management include implementing a policy that addresses:

- limits on the balance sheet mix and maturities of capital, deposits, loans and investments;
- criteria for pricing of deposits and loans;
- limits on the exposure to foreign currency risk;
- limits on the exposure to changes in interest rates;
- use of appropriate techniques for measuring the credit union's structural risk and evaluating the potential impact under current and reasonably foreseeable scenarios;
- the use of analysis and appropriate consultation for the purchase of derivatives.

Expectations for prudent structural risk management are outlined in DICO's "Guidance Note: Structural (Interest Rate) Risk Measurement and Management" which is available on our website.

7. Liquidity Risk Management

Your credit union's Board and staff must manage closely the organization's liquidity, or access to cash. The credit union must be able to meet the demand for cash withdrawals, financing commitments for approved loans and lines of credit, and routine operating outflows of cash.

It is a sound business and financial practice for a credit union to have appropriate and prudent policies, procedures and controls to manage the liquidity risk of the credit union.

The fundamental elements of liquidity risk management include implementing a policy that addresses:

- limits on the sources, quality and amount of liquid assets to meet normal operational and contingency funding for significant deposit withdrawals and regulatory requirements.

Class 1 credit unions are required to follow prescribed rules for liquidity risk management which set out minimum levels of liquidity and the types of assets that may be used for liquidity purposes.

Expectations for prudent liquidity risk management for Class 2 credit unions are outlined in DICO's "Guidance Note: Liquidity" which is available on our website.

Self Assessment

Annually, each credit union is required to review and assess its operations and submit to DICO a Board resolution, as prescribed by DICO, confirming that:

- management has provided a representation letter to the Board of directors regarding its assessment of adherence to management's responsibilities under the standards of sound business and financial practices;
- the Board of directors is familiar with, and is acting in compliance with the standards of sound business and financial practices.

Sample Self Assessment Workbooks for the Board provide:

- tools to help assess the effectiveness of its governance practices as outlined in DICO By-Law #5 and record progress for ensuring compliance with the by-law each year;
- the criteria which will be used by DICO to confirm adherence to the Governance standard of By-law #5 for the Board of directors.

There is no requirement to complete or file the workbook with DICO. Credit unions may develop their own assessment tools or modify the workbook to suit their particular requirements.

A sample Board resolution is provided in the self assessment workbooks and sets out DICO's minimum requirements. Credit union boards are free to expand on these minimum requirements as appropriate to meet their needs.

Board Meetings

In fulfilling its responsibilities, the board should establish an appropriate work plan and board meeting agendas which outline the frequency of various items and regular reports that it expects to receive and review. Agenda items should be presented in a consistent manner with items identified for either decision or information. Supporting documentation should be made available at least one week prior to the meeting to allow sufficient time for directors to understand the issues involved and identify any material issues that need to be clarified.

Board meetings include participation of the management team to provide additional information, comment on various items and reports presented and to address any questions or issues raised. Detailed minutes should be maintained of all issues raised and reviewed, including details of all approvals and any dissenting comments or votes where appropriate.

An “in camera” (i.e., without management present) session is an important component of the board meeting and should be regularly held either before or following the meeting. It allows directors to address confidential issues outside normal operations. For example, board evaluation, CEO performance and compensation, whistle-blower allegations.

The Board may also invite third parties (e.g., lawyer, accountant, internal auditor, external auditor, etc.) to attend the meeting to provide advice. It also facilitates director orientation, allows directors to discuss current and emerging risk issues and to ask questions concerning upcoming Board agenda items and issues in a more informal setting. This helps improve director’s cooperation, develop closer relationships, share knowledge and experiences and achieve a consensus on any potentially contentious issue.

An in camera session also helps to improve the effectiveness and efficiency of the regular session of the board meeting. An agenda should be created prior to each meeting with input from all directors.

Minutes or information on issues discussed during in camera sessions are confidential and should be maintained by the Chair or their delegate. Minutes must be recorded for any decisions made. Management should be provided a copy of the in-camera agenda and following the meeting should be briefed by the Chair or delegate regarding items discussed.

Reports to the Board

The board of directors of your credit union, with the assistance of management, is responsible for monitoring the performance of the credit union, and ensuring the policies and business plan are followed. Listed below is the minimum type of information you, as a director, should expect to review to properly monitor the credit union's performance.

| Report | Scope | Frequency |
|---|--|--|
| Minutes | <ul style="list-style-type: none"> Minutes of previous board meetings Minutes of committee meetings | Every board meeting |
| Governance | <ul style="list-style-type: none"> Compliance with the Code of Conduct Performance of the general manager Annual report on the general competency and quality of staff | Annually |
| Capital Management | By-law #5 reporting requirements | Every board meeting |
| Credit Risk Management | By-law #5 reporting requirements | Every board meeting |
| Operational Risk Management | By-law #5 reporting requirements | At least quarterly |
| Market Risk Management | By-law #5 reporting requirement | Every board meeting |
| Structural Risk Management | <ul style="list-style-type: none"> By-law #5 reporting requirements regulatory reporting requirements, (section 73 of Regulation 237/09) | Every board meeting |
| Liquidity Risk Management | By-law #5 reporting requirements | Every board meeting |
| Internal Controls (prepared by the Audit Committee) | <ul style="list-style-type: none"> Effectiveness of internal controls Regulatory reporting requirements set out in Section 27 of Regulation 237/09 Can also include the Report of the Internal Auditor, where appropriate | At least Quarterly (Refer to The Audit Committee Handbook) |
| Reports by other committees | Activities and progress of the committee | As necessary |
| Report of the External Auditor | <ul style="list-style-type: none"> Compliance with generally accepted accounting principles (GAAP) Report made in accordance with Section 172 of the Act (i.e. internal control deficiencies) | Annually |
| Examination reports by DICO | <ul style="list-style-type: none"> Regulatory compliance Risk assessment Compliance with sound business and financial practices | As advised |

DICO's Authority

DICO promotes the safety and soundness of the credit union sector in Ontario by identifying, monitoring and addressing risks. DICO is responsible for ensuring that credit unions establish and comply with prudent sound business and financial practices.

Where a credit union is in non-compliance with the standards of By-law #5, DICO may impose conditions of deposit insurance to address that risk and resolve identified weaknesses.

Where a credit union is in material non-compliance with the standards, DICO may issue a **compliance order** that restricts or revokes certain activities until such time as the deficiencies have been appropriately addressed.

Where a credit union's non-compliance with By-law #5 represents an unacceptable level of risk, DICO may order a credit union subject to **Supervision**. DICO works closely with the board of a credit union under Supervision to ensure the noted deficiencies are actively addressed.

Where there is a high risk that the credit union will fail, DICO may place a credit union under **Administration**. DICO directly manages credit unions under Administration and removes the board of directors. The aim of Administration is to protect depositors and thereby minimize the risk of future loss to DICO's Deposit Insurance Reserve Fund.

In addition, credit unions are required to obtain DICO's prior approval for certain transactions and DICO may impose administrative penalties for contravention of the requirements of the Act.

Compliance Orders

DICO may issue a Compliance Order where:

- the credit union is not complying with the requirements set out in the Act and accompanying regulations;
- DICO considers the interest of a credit union's members, shareholders or depositors are at risk;
- DICO considers it necessary to ensure the financial security and integrity of the credit union.

Each compliance order will identify the authority for issuing the Order and comprehensive details outlining the rationale, criteria and evidence DICO has relied upon for issuing the order. The order will also outline the conditions and actions required for compliance, the timeframe for compliance and any potential consequences for failure to comply.

Prior to issuing an order, DICO will meet with the board to discuss the circumstances for the order and provide the credit union with appropriate notice of the order. All compliance orders are subject to an appeal process by the credit union.

Full details regarding compliance orders can be found on DICO's website.

Key Sections of the Act and Regulations

| Subject | Section of the Act | Section of Regulation 237/09 |
|--|--------------------|------------------------------|
| Directors | | |
| Restriction on the payment of dividends | 67 | |
| Misrepresentation in an offering statement | 82 | |
| Qualification of directors | 91 | |
| Disqualification of directors | 92 | |
| Disclosure of interest by candidates | 94.1 | |
| Removal of a director, including failure to regularly attend Board meetings | 99 to 100 | |
| Duties of directors (confidentiality, compliance with laws, conflicts of interest rules) | 142 to 149 | |
| Requirement for bond | 151 | 29, 30 |
| Personal liability of directors | 152 to 155 | |
| Insurance for directors | 156 to 158 | |
| Restricted party transactions including loans made to directors | 207 to 210 | Part X |
| Board of Directors | | |
| Duties of the Board; requirement to establish policies, procedures and by-laws | 104 | 25 |
| Powers of the Board | 105 to 108 | |
| Annual and general meetings | 212 to 215 | 26 |
| Committees | | |
| Establishing committees Powers and duties of the Audit Committees | 109, 125-128 | 27 |
| Duties of committee members (confidentiality, compliance with laws, conflicts of interest rules) | 142 to 149 | |

| Subject | Section of the Act | Section of Regulation 237/09 |
|---|--------------------|------------------------------|
| Credit Union | | |
| Objects and powers | 24 to 26 | |
| Business powers of the credit union | Part VIII | Part VII |
| Consideration for shares; prohibition against commission on sale of shares | 59 | |
| Capital and liquidity requirements | 84 | 15 to 23 |
| Provision for doubtful loans and reserves | 90 | 24 |
| Restricted party transactions | 207 | Part X |
| Officers | | |
| Designated officers and the Corporate Secretary | 140 to 141 | |
| Duties of officers (confidentiality, compliance with laws, conflicts of interest rules) | 142 to 149.1 | |
| Members | | |
| Members' rights | 37 to 41 | |
| Annual and general meetings | 212 to 215 | |
| Financial Services Commission of Ontario | | |
| Documents to be kept | 231 | 85 |
| Enforcement of the Act | Part XII | |
| Offenses and administrative penalties | Part XVII | |
| Deposit Insurance Corporation of Ontario | | |
| Information to DICO | 226 | |
| Objects and powers | Part XIV | Part XIV |
| Supervision | 279-293 | |
| Administration | 294-295 | |

Glossary

The Act - The Ontario *Credit Unions and Caisses Populaires Act, 1994* (publication available from the Government of Ontario (www.publications.serviceontario.ca)).

Bonding insurance - A contract which insures the credit union against financial losses caused by counterfeit money, robbery, burglary, theft, vandalism, extortion, forgery and member/employee fraud.

Caisse populaire - The French language equivalent of a credit union. In Ontario, caisses populaires are incorporated under the same Act as credit unions and are subject to the same regulations. Caisses populaires conduct business primarily in French. (*For purposes of this Handbook, credit union is defined to mean a credit union or caisse populaire.*)

Capital - Represents the difference in value between a credit union's assets (such as its loans and fixed assets that it holds), and its liabilities (such as deposits by its members and debts owed to its creditors).

Credit risk - The risk that promised cash flows on a loan, mortgage or other financial instrument may not be paid in full.

Credit union - A co-operative financial institution, that provides financial services exclusively to its membership. (*For purposes of this Handbook, credit union is defined to mean a credit union or caisse populaire.*)

Deposit insurance - Insurance protection that is provided by DICO on depositors' accounts, up to prescribed limits should the credit union go out of business and is unable to pay all of its depositors. Further information on deposit insurance is provided in DICO's By-law #3 and on our web site www.dico.com.

Derivatives - A derivative instrument is a financial contract whose value fluctuates in relation to the performance of an underlying asset or market index (e.g. interest rate swap).

Director's liability insurance - A contract which insures director's against liability arising from negligent acts inadvertently taken by directors in the course of their duties.

External auditors - Professional accountants who express an opinion on the financial statements of the credit union and perform other audit or accounting functions.

Prudent Person approach - the concept that directors must act wisely in all business matters and exercise good judgment and common sense in adhering to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return while managing the affairs of the credit union.

Regulations - The regulations proclaimed under the Ontario *Credit Unions and Caisses Populaires Act, 1994*. (www.publications.serviceontario.ca)



Ontario

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