STANDARDS OF SOUND BUSINESS AND FINANCIAL PRACTICES

DICO BY-LAW NO. 5

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DEPOSIT INSURANCE CORPORATION OF ONTARIO
BY-LAW RESPECTING
STANDARDS OF SOUND BUSINESS AND FINANCIAL PRACTICES
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Preamble

This by-law, which has been authorized by the Deposit Insurance Corporation of Ontario ("DICO") and approved by the Lieutenant Governor in council, sets standards of sound business and financial practices ("standards") for credit unions and caisses populaires under the provisions of the *Credit Unions and Caisses Populaires Act*, 1994 (the "Act").

The standards set out DICO's expectations regarding the business and financial practices of member institutions and are designed in such a way to make them adaptable to every member institution, regardless of size or complexity, recognizing that approaches will differ among member institutions.

Rationale

The risk that DICO incurs in providing deposit insurance is in large part a reflection of the exposures faced or taken on by its member institutions. Experience has shown that well-managed institutions are less likely to encounter difficulties that could result in DICO having to take action and, ultimately, having to pay the insured claims of depositors. Institutions are exposed to a number of risks that can adversely affect their ability to achieve their business objectives and execute their business strategies, or that may result in a loss of earnings, capital or reputation. By implementing an appropriate risk management process which includes documented policies, procedures, measurement techniques and controls, institutions are more likely to enhance membership value while preserving safety and soundness.

Responsibilities

The board of directors is ultimately responsible for ensuring that the member institution is operated in a safe and prudent manner and for ensuring adherence to these 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 member institution 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.

Reporting Requirements

Annually, as a condition of the renewal of the policy of deposit insurance, each member institution will be required to review and assess the operations of the institution and submit to DICO a board resolution, as prescribed by the Corporation, 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.

STANDARDS

The following are standards of sound business and financial practices:

1(a) Governance: Board of Directors

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

The care, diligence, skill and prudence exhibited by a member institution's directors has a critical influence on the institution'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 standards 2 to 7 and obtaining reasonable assurance that the institution 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;
- establishing the business objectives of the institution consistent with cooperative principles and approving the institution's business strategy and business plans;
- evaluating the institution'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 an institution to ensure that the institution 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 member institution 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 standards 2 to 7;
- 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 institution's business strategy and business plans and any material risk that may affect business objectives.

2. Capital Management

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

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 member institution and to support the current and planned operations;
- distribution of dividends and redemptions of capital instruments to members.

3. Credit Risk Management

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

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.

4. Operational Risk Management

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

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 institution'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

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

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.

6. Structural Risk Management

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

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 institution'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.

7. Liquidity Risk Management

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

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, contingency funding for significant deposit withdrawals and regulatory requirements.

Interpretation

The following definitions apply with respect to this By-law:

"appropriate" means that it is suitable for its intended purpose, having regard to the nature, magnitude, complexity and implications of the matter in question.

"co-operative principles" are outlined in the "Statement on the Co-operative Identity" from the International Co-operative Alliance. These principles include, voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; co-operation among co-operatives; concern for community.

"effective" means that it is achieving, or can reasonably be expected to achieve, its intended purpose.

"market" means the geographic area of product and service offerings and/or economic forces of influence which can affect the value of the member institution's assets, liabilities, capital or earnings.

"material or significant risk" means a risk or a combination of risks that is important because of the probability of occurrence, the severity of impact or both, that could have an adverse effect on the institution's earnings, liquidity, capital or reputation, or on the ability of the institution to achieve its business objectives or implement its business strategy and business plans.

"prudent" means that it is the result of careful and practical judgment, having regard to business objectives, risks, the business and economic environment, and the quantity, quality and sustainability of earnings, liquidity, capital and other resources.

Transitional
A member institution will be required to be in full compliance with this by-law by the end of its first fiscal year end after July 1, 2005.

Effective Date
By-law No. 5 of DICO made on September 10, 1997, is hereby repealed and replaced by this by-law.

Enacted as a by-law of DICO by the Board of Directors on the 15th day of September, 2004

Approved by the Lieutenant Governor in Council by Order dated 15th day of December 2004.

The following is a copy of the annual Board Resolution as prescribed by DICO under the Reporting Requirements of By-law NO.5. A copy of the Resolution is to be forwarded to DICO within 75 days of the institution's fiscal year end.

Resolution of the Board of Directors

It is resolved that:
This resolution is made in respect of <name of member institution> (the "member institution") and concerns its adherence to the Deposit Insurance Corporation of Ontario ("DICO") Standards of Sound Business and Financial Practices (the "Standards") as outlined in DICO By-law No.5.

The board of directors (the "board ") of the member institution is familiar with the contents of the Standards By-law and acknowledges its responsibilities under the Standards, which include:

- establishing appropriate and prudent risk management policies for each of the Standards and obtaining reasonable assurance that the institution 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;
- establishing the business objectives of the institution consistent with cooperative principles and approving the institution's business strategy and business plans;
- evaluating the institution's actual operating and financial results against business plans;
- evaluating the effectiveness of management.

The board of directors of the member institution is, to the best of its knowledge and abilities, fulfilling its responsibilities under the Standards [if applicable, add: "except as indicated below"].

The board has carefully considered the management representation letter dated <month> <day>, <year> addressed to the board concerning adherence to the Standards. The board has also carefully considered other information, and made such inquiries as it deems appropriate, relevant to the forming of its opinion on whether the member is following the Standards.

It is the opinion of the board that to the best of its knowledge, it has obtained reasonable assurance that the member institution is following the Standards [add, if applicable: "except as indicated in the representation letter and/or below"].

[If applicable, add: "With respect to the deficiency (ies) or exception(s) not indicated in the representation letter, the board of directors confirms that an action plan(plans) addressing their correction has(have) been prepared and is(are) being implemented. A copy of the action plan(s) is being (has been) submitted to DICO and/or the Financial Services Commission of Ontario."]

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The foregoing is certified as a true copy of a resolution of the board of directors of <name of member institution> passed at a meeting of the board held on the <day> of <month>, <year>.

Dated at <insert place> this <day>of<month>, <year>.

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Corporate Secretary

Copy to: Deposit Insurance Corporation of Ontario