Ontario

Deposit Insurance Corporation of Ontario

Société ontarienne d'assurance-dépôts

Guidance Note:

Corporate Governance - Management

January 2018

Ce document est aussi disponible en français.

Applicability

The Guidance Note: Corporate Governance – Management (the "Guidance Note") is for use by all credit unions. It outlines the minimum requirements of Management for sound corporate governance of a credit union as set out in the Credit Union and Caisse Populaire Act, 1994 (the "Act"), Ontario Regulation 237/09 (the "Regulation") and DICO By-law No.5 – Standards of Sound Business and Financial Practices ("By-law No. 5"). It sets out the criteria DICO will use when evaluating the effectiveness of corporate governance practices for management during the examination process and will also form an input into the Differential Premium Score Determination for deposit insurance premium purposes.

The Guidance Note sets out fundamental concepts that form the basis of the responsibilities of management for implementing effective governance policies and risk management practices to ensure the continued viability of the credit union in the best interest of its depositors.

This Guidance Note complements the information provided in, and should be read in conjunction with, other DICO guidance notes and supporting publications available on DICO's website (www.dico.com). These publications include:

- DICO By-laws
- Guidance Notes
- Application Guides
- Handbooks
- Checklists
- Manuals
- Webinars
- Advisories
- Other additional tools

Throughout this document:

- the term "credit union" also refers to "caisse populaire" and "league".
- the term "Board" refers to either the entire Board or a committee of the Board that has been delegated a particular element of Board oversight.
- the term "Senior Management" refers to the Chief Executive Officer (CEO) and individuals who are directly accountable to the CEO. In addition to the CEO's direct reports, such as the heads of business units, Senior Management may also include the executives responsible for the oversight functions, such as the Chief Financial Officer, Chief Risk Officer, Chief Compliance Officer, Chief Internal Auditor, and Chief Actuary.
- the term "report" refers to a written report.
- The term "review' refers to review and documentation within Board/Committee meeting minutes.
- The terms "regular" or "regularly" in reference to timing of reviews and reporting will vary depending on the size and complexity of the credit union.

Contents

Introduction

Effective corporate governance is a result of both the structural elements (such as policies, sound business practices and accountabilities) and the behavioural factors that enhance the quality of the duty of care and diligence practiced by directors and management in achieving the mandate of the Board. Section 104(1) of the Act sets out the duties of the Board to manage or supervise the management of the credit union. The Board manages the credit union through the appointment of the CEO, and assigns various authorities to Senior Management through job descriptions, corporate polices and specific directions.

Senior Management is responsible for ensuring that the credit union applies the processes, procedures and controls necessary to prudently manage risk. Also, Senior Management provides the board of directors with timely, relevant, accurate and complete information to enable it to assess that assigned responsibilities are being discharged effectively.

Senior Management is responsible to the Board to perform its delegated duties honestly and competently thus enabling the Board to provide effective stewardship of the credit union. Effective stewardship requires that everyone involved with the management or operation of the credit union, acts honestly, in good faith and in the best interest of the credit union. The Board performs its stewardship function by setting and monitoring compliance with the credit union's:

- corporate culture and values;
- business philosophy and strategic direction;
- financial soundness and performance;
- quality and competencies of management and staff; and
- risk profile - particularly the Board-approved risk appetite and risk tolerance of the credit union with respect to the management of key inherent financial and operating risks, as well as strategic risks.

The quality of Senior Management's performance is demonstrated by its effectiveness in:

- instilling the desired corporate culture and values;
- overseeing the execution of approved strategies and business plans; and
- providing successful management of the credit union's operations and risks, with due regard to safety and soundness.

This includes:

- developing and implementing strategies and plans to achieve business objectives that are appropriate and prudent, in the context of the regulatory, competitive and economic environment;

- regularly monitoring the execution of approved plans to ensure objectives are achieved or strategies are appropriately adjusted to deal with changes in business or economic conditions;
- actively monitoring adherence to approved corporate values, policies, organizational and procedural controls, and ensuring compliance with all applicable legislative requirements;
- ensuring appropriate and timely action is taken to remedy any deficiencies that may arise, including issues brought to it by other internal and external control functions and regulators;
- ensuring management information systems provide timely and relevant information to support its oversight responsibilities;
- attracting, developing and retaining knowledgeable staff, and maintaining an effective working environment;
- ensuring employees clearly understand their responsibilities and accountabilities;
- for more complex credit unions-developing and maintaining effective risk management processes including a robust enterprise risk management framework appropriate to the size and complexity of the credit union; and
- keeping the Board and its committees fully apprised of business conditions, strategic opportunities and concerns, operating performance and issues that could significantly affect the well-being of the credit union.

Senior Management is accountable for implementing the Board’s decisions, and responsible for directing and overseeing the operations of the credit union. Senior Management is also responsible for ensuring adherence to the standards of sound business and financial practices outlined in DICO By-law No. 5.

This document provides credit unions with information that will assist in the development of appropriate standards for management and outlines DICO’s expectations and assessment of the effectiveness of the standards the credit union has put in place. These standards have been grouped into four main categories: Risk Management, Business Strategy and Business Plans, Operational and Financial Results, and Board Reports.

Throughout this Guidance Note, where the frequency of reviews, reporting and other periodic exercises is defined as “at least annually”, it is expected the frequency will increase with the level of riskiness and complexity of the activities under review. (i.e. semi-annually, quarterly, monthly).

Risk Management

IMPLEMENTING APPROPRIATE AND PRUDENT RISK MANAGEMENT POLICIES, PROCEDURES AND CONTROLS

One of the Board’s primary risk governance functions is the establishment of the risk appetite and risk tolerances of the credit union. Senior Management is responsible for implementing robust risk management processes that align with the risk governance framework set out by the Board. Senior Management should be able to demonstrate that the credit union’s significant risks are appropriately and effectively managed individually and in aggregate across the organization.

Effective risk management procedures and controls include activities such as approval authorities and authorization limits, verifications, reconciliation and segregation of duties, as well as systems to measure, monitor and provide information about risk exposures. Collectively, they need to form an integrated system designed to ensure necessary actions are being taken to facilitate the achievement of business objectives in a prudent and controlled manner.

This includes assigning "ownership" for the management and control of specific risks to qualified, competent, and appropriately experienced individuals and providing those persons with sufficient and appropriate resources and tools to achieve expectations. An effective risk management framework requires that Senior Management has an expert level understanding of the nature of the inherent risks being undertaken and the impact of those risks on the operations, profitability and capital of the credit union. Senior Management should regularly monitor the ongoing status or change in status or severity of all major risks, including strategies and specific methodologies in place to manage these risks.

At a minimum, Senior Management is expected to ensure appropriate and prudent risk management policies and practices are developed, approved and implemented addressing the following risk management areas:

- Capital Management;
- Credit Risk Management;
- Operational Management;
- IT Risk Management;
- Market Risk Management;
- Structural Risk Management;
- Liquidity Management;
- Enterprise Risk Management

At a minimum, DICO expects Senior Management to ensure:

- risk management practices are proactive and effective;
- clear lines of responsibility and accountability for managing specific risks have been established and communicated;
- individuals at all levels should be aware of the risks related to their responsibilities and the requirement for them to manage these risks; and
- significant risk exposures have been identified, reported to the Board and are being managed by competent and qualified individuals.

MONITORING THE EFFECTIVENESS OF RISK MANAGEMENT PRACTICES AND CONTROLS FOR THE CREDIT UNION'S SIGNIFICANT RISKS

A credit union's risk management and control processes, no matter how well designed and applied, can provide only reasonable assurance of achievement of risk management objectives. There are inherent limitations in all systems, including the possibility that judgement can sometimes be flawed. Breakdowns can occur because of mistakes and some rules can be circumvented. Accordingly, it is important that risk management be supported by an effective control environment.

On an ongoing basis, Senior Management should monitor the effectiveness of risk management practices and controls. Regular reviews provide assurance that the credit union is adhering to its risk management policies and help identify any situations that have led (or may lead) to changes in its risk profile due to internal and external factors.

At a minimum, DICO expects Senior Management to ensure:

- processes are being implemented to verify that risk management practices support the achievement of established policies, business objectives and compliance with the corporation's risk appetite;
- weaknesses or deficiencies have been appropriately reported and addressed;
- unexpected results are fully evaluated against established policies and acceptable targets; and
- appropriate changes are made to procedures, controls and resource allocation to resolve elevated or unexpected risk exposures.

Business Strategy and Business Plans

DEVELOPING AND IMPLEMENTING AN APPROPRIATE AND PRUDENT BUSINESS STRATEGY AND BUSINESS PLANS

The business strategy establishes the objectives of the credit union. It includes:

- an analysis of both the internal and external environment;
- the type of business activities that will be conducted;

- the significant risks inherent in those activities and how these will be mitigated;
- the key functions and resources required to fulfill these activities; and
- the short and long-term operating and financial results expected from this strategy.

A business plan is a detailed description of how a credit union plans to carry out particular operations in implementing its business strategy. Business plans help to ensure that business activities will be conducted within the context of established business objectives and strategy. Senior Management is accountable to the depositors and shareholders and the Board for the financial and operational performance of the credit union in accordance with its approved strategic and business plans. Senior Management should ensure policies, practices and processes are established and maintained to achieve business objectives and monitor, analyze and report the results of various aspects of the credit union's business and financial targets.

At a minimum, DICO expects Senior Management to ensure:

- the strategic plan covers an appropriate business cycle for the size and complexity of the credit union;
- the basis for conclusions and recommendations are fully supported by documented sound rationale;
- appropriate financial targets have been established;
- strategies to achieve financial targets are appropriate for the risk profile of the credit union and do not result in elevated risk exposure; and
- controls are in place that are fully aligned with business objectives and financial targets.

Operational and Financial Results

EFFECTIVELY MONITORING AND EVALUATING THE CREDIT UNION'S ACTUAL OPERATING AND FINANCIAL PERFORMANCE AND RESULTS AGAINST BUSINESS PLANS AND ADDRESSING MATERIAL VARIANCES

Ongoing review and analysis of the business plan by Senior Management is required to ensure the credit union continues to operate within the scope outlined in the business strategy. Senior Management will assign appropriate responsibilities to ensure operational and financial performance are continuously monitored against key metrics and any required recommendations are developed to address material variances. These may include modifications to procedures, resource allocations, employee training, business development or new product initiatives.

Any material variations should be reported to the Board along with appropriate action plans to address them. Senior Management will ensure remediation plans are implemented and provide the Board with regular updates until material variances are appropriately resolved.

Senior Management should appropriately implement the recommendations of external reviews (for example, DICO examinations and External Audits) which provide further insight into deficiencies observed in operational and financial processes and performance.

At a minimum, DICO expects Senior Management to ensure:

- controls are implemented to ensure business objectives are achieved according to board policy;
- appropriate criteria and key metrics have been developed to evaluate performance in achieving the business objectives, strategy and plans;
- operational and financial performance is continuously and effectively monitored;
- recommendations to address material variances are fully documented and evaluated; and
- action plans to address material variances are developed and implemented.

Board Reporting

PROVIDING THE BOARD OF DIRECTORS WITH TIMELY, RELEVANT, AND ACCURATE REPORTS ON THE IMPLEMENTATION OF THE BUSINESS STRATEGY, BUSINESS PLANS AND ANY SIGNIFICANT RISK AND MATERIAL DEFICIENCIES THAT MAY AFFECT THE ACHIEVEMENT OF BUSINESS OBJECTIVES AND FINANCIAL STABILITY

Senior Management will provide timely and accurate information to the Board in order to allow it to make well informed decisions about the issues and opportunities facing the credit union. It is the responsibility of Senior Management to ensure the Board is provided with this information as well as other information the Board may request, including analysis and advice in order to make and support recommendations on proposed activities with respect to amendments to organizational objectives, business strategy or key policies.

Senior Management should include in Board reporting assurances that policies, processes and controls are adequate, that they are operating appropriately, and all areas of significant risk and material deficiencies are being addressed.

Senior Management should provide written reports to the Board, at least annually, on risks to which the credit union is exposed that:

- summarize the nature and magnitude of significant risks and material deficiencies;
- highlight all material deficiencies and significant risks that exceed the credit union's acceptable risk tolerance levels established by the Board;
- identify the timeframe and status of any additional risk management activities that may be required to bring risks within approved risk tolerance levels;
- identify any negative trends of higher risk areas and any changes to risk management activities;
- highlight any new risks including their risk assessment, risk response and management activities;
- identify any emerging risks; and
- summarize any exceptions to Board approved policies or limits for key risks.

At a minimum, reporting should be submitted to the Board with respect to the following topics:

- Capital
- Credit Risk Management
- Operational Risk Management
- IT Risk Management
- Market Risk Management
- Structural Risk Management
- Liquidity Management
- Enterprise Risk Management (ERM)

ERM Program

When developing an effective ERM program, Senior Management should consider the basic principle, methodology and processes that may need to be modified and appropriately scaled to reflect the credit union's size and complexity. This will include consideration of the range of products and services offered to depositors, capital structure, geographic coverage, business strategies and technology. As a credit union grows in size and complexity the ERM program should evolve to ensure that all significant new, emerging and increased risks are appropriately considered and addressed as part of the on-going review and assessment process.

At a minimum, DICO expects Senior Management to ensure that reports to the board:

- are comprehensive and provide sufficient and appropriate information to help the Board determine whether the credit union is adhering to its risk management policies;
- report all material deficiencies in risk management practices and identify how these are being addressed and when the deficiencies are expected to be resolved;
- provide assurances the credit union is in compliance with all applicable legislation;
- compare actual performance and business risk measurements relative to plan and previous year to date performance;
- identify any material operating and financial variances of actual results to plan;
- outline initiatives and plans to address any material operational or financial deficiencies; and
- provide timely and accurate information regarding the progress of adhering to the strategic plan and any recommendations to address adverse conditions.

DICO Assessment Criteria

The assessment criteria set out below are in addition to specific assessment criteria set out in other DICO Guidance Notes.

As part of its on-going risk assessment and examination process of Senior Management, DICO will assess the adequacy of the risk management program within the context of the credit union's size, complexity and risk profile. In addition to a review of the risk management policies, practices and adherence to the same, DICO will assess the level to which Senior Management completes the following tasks:

- develops and effectively implements a prudent business strategy and business plans with appropriate consideration and analysis supporting recommendations for Board approval;
- submits on-going reviews to the Board that appropriately identify variances to business plans and strategies and ensures adjustments are implemented to effectively resolve any adverse condition; and
- providing timely, relevant, and accurate reports to the Board on the implementation of the credit union's business strategy, business and financial plans, variance analysis and any significant risks and material deficiencies that may affect business objectives and financial stability.

Under By-law No. 5, each credit union is required to attest annually 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.

To complete the management representation letter, Senior Management should review internal management assessments by individuals who manage the credit union's operations as to whether the significant risks and material deficiencies in their areas of responsibility are being identified and addressed. Senior Management should also review periodic validations that the assessments have been conducted competently and with integrity and the significant deficiencies are being rectified. A sample of a management representation letter is included in the Self Assessment Workbook: Corporate Governance – Management.

The board will determine when the letter should be provided by management and what additional evidence or documentation is required.

The representation letter should at a minimum:

- confirm management is familiar with the contents and are fulfilling their responsibilities in By-law No. 5;
- identify any outstanding deficiencies; and
- include an action plan to address identified deficiencies.