CREDIT UNION DEPOSIT GUARANTEE CORPORATION
P.O. Box 3030
2055 Albert Street
Regina, SK S4P 3G8
www.cudgc.sk.ca
PH (306) 566-1286
FX (306) 566-1770

Date: July 8, 2014

To: Chief Executive Officers, General Managers and Board Presidents
Saskatchewan Credit Unions

From: Robb Elchuk
Manager, Regulatory Policy and Prevention

Subject: **Corporate Governance Regulatory Guideline – 2014-01**

On March 27, Credit Union Deposit Guarantee Corporation (the Corporation) published its draft corporate governance regulatory guideline. The comment period ended on May 2. Feedback was received from eight credit unions and the Financial and Consumer Affairs Authority. The Corporation thanks everyone who provided comments. Now final, this guideline replaces the existing corporate governance guideline that was issued in conjunction with the revised Standards of Sound Business Practice (Standards) in 2013.

The purpose of this guideline is to communicate key principles and the Corporation's expectations with respect to corporate governance. It is aligned with internationally published principles and best practices, and supplements *The Credit Union Act, 1998*, the Standards and the Corporation's risk-based supervisory framework.

Based on feedback received from credit unions, two minor revisions have been made to the guideline since it was issued in draft form:

Board Responsibilities of Credit Unions
- clarification that credit unions are expected to pay special attention to the performance, composition and activities of subsidiary boards, especially where the subsidiary is involved in providing services to the general public and/or other entities

Changes to the Board and Senior Management
- the requirement for credit unions to notify the Corporation of changes to the membership of the board and senior management when they occur, not when they have the potential to occur

The Corporation also wishes to clarify/reiterate the following based on feedback received:
- The Corporation recognizes that credit unions differ in terms of size, nature, scope and complexity of operations, corporate strategy and risk profile. Credit unions are expected to consider their specific circumstances and apply professional judgement when scaling the principles and expectations contained in the guideline to their organization.
- The Corporation recognizes that the skills, abilities and contribution of individual directors vary, and that some board members have more financial industry and risk management expertise than others. Individual directors are expected to seek educational opportunities to increase their knowledge and expertise so that they can fully understand the business and risks undertaken by the credit union, as well as

developments in corporate and risk governance practices. Credit unions are also expected to communicate the necessary skills and qualities required in advance of the director election process, and actively recruit candidates with the necessary skills and qualities to run for board membership.

- Boards are responsible to manage and oversee the appointment, performance review, compensation and succession plans of the CEO/GM. As part of their oversight role, the Corporation expects boards to approve, where appropriate, the appointment, performance review, compensation and succession plans of senior management, and the heads of oversight functions. Boards are also expected to approve, where appropriate, the mandate, resources and budgets of the oversight functions.

Beginning immediately, the Corporation will look for evidence that credit unions are taking steps to evaluate and update their corporate governance practices to align with the principles and expectations contained in the guideline.

The Corporation appreciates your continued support to ensure that requirements keep pace with broader regulatory developments and remain credible within the industry. Please feel free to contact me at 306.566.1296 or robb.elchuk@cudgc.sk.ca if you have any questions.

Robb Elchuk

Robb Elchuk

cc.: Keith Nixon, CEO, SaskCentral
Dave Wild, Registrar of Credit Unions
Cory Peters, Director of Consumer Credit Division,
Financial and Consumer Affairs Authority

REGULATORY GUIDELINE

Corporate Governance

SYSTEM COMMUNICATION NUMBER

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I. INTRODUCTION

This regulatory guideline is a Regulatory Guidance Document as contemplated by the Standards of Sound Business Practice (the Standards). It supplements and expands upon section 1, *Corporate Governance* and section 2.4, *Risk Management* of the Standards and must be adhered to by Saskatchewan credit unions.

II. PURPOSE AND SCOPE

The purpose of this guideline is to communicate key principles and the expectations of Credit Union Deposit Guarantee Corporation (the Corporation) with respect to corporate governance.

The Corporation recognizes that credit unions have different corporate governance structures and practices depending on their size, nature, scope and complexity of operations, corporate strategy and risk profile.

The Corporation expects boards and senior management to be proactive, and aware of best practices related to corporate governance that are applicable to their organization. Where appropriate, credit unions are expected to adopt these best practices.

III. CORPORATE GOVERNANCE FOR CREDIT UNIONS

DEFINING CORPORATE GOVERNANCE

Corporate governance involves a set of relationships between a credit union's board, senior management, members and other stakeholders. Corporate governance provides the structure through which the objectives of the organization are set, and the means of attaining those objectives and monitoring performance. Effective corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the organization and its stakeholders, and facilitate effective monitoring.

Appropriate organizational structures, policies and other controls help promote, but do not ensure, good corporate governance. Governance lapses can still occur through undesirable behavior and corporate values. Effective corporate governance is not only the result of hard structural elements, but also soft behavioral factors driven by dedicated directors and management performing their duty of care to the organization. A demonstrated corporate culture that supports and provides appropriate norms and incentives for professional and responsible behavior is an essential foundation of good governance. In this regard, the board is expected to take the lead in establishing the tone at the top, and in setting professional standards and corporate values that promote integrity for itself, senior management and other employees.

What makes organizational structures and policies effective, in practice, are knowledgeable and competent individuals with a clear understanding of their role, and a strong commitment to carrying out their respective responsibilities.

THE BOARD, SENIOR MANAGEMENT AND OVERSIGHT FUNCTIONS

A credit union's board and senior management are ultimately accountable for the credit union's safety and soundness, and its compliance with legislation and the Standards. In this guideline, the roles of the board and senior management are highlighted. The board is responsible for providing stewardship, including direction-setting and general oversight of the management and operations of the credit union. Senior management is accountable for facilitating the board's oversight and implementing its decisions, and is responsible for directing and overseeing the operations of the credit union. This distinction in the responsibilities between the board and senior management is critical.

In carrying out its responsibilities, senior management may delegate some of its responsibilities to the credit union's oversight functions. Oversight functions include financial management, audit, compliance and risk management. The oversight functions are responsible for providing enterprise-wide oversight of operational management.

The composition of the senior management of a credit union will vary from institution to institution. Senior management is comprised of the chief executive officer (CEO) or general manager (GM) and individuals who are directly accountable to the CEO/GM. In addition to the CEO's direct reports, such as the heads of business units, senior management may also include individuals responsible for the oversight functions such as the chief financial officer (CFO), chief risk officer (CRO), chief internal auditor and chief compliance officer (CCO), or the equivalent for each position.

THE UNIQUENESS OF FINANCIAL INSTITUTIONS

The quality of corporate governance practices among financial institutions is an important factor in maintaining the confidence of depositors, stakeholders and the general public. This guideline, therefore, draws attention to specific areas of corporate governance that are especially important for credit unions and other financial institutions (e.g., risk governance), owing to the unique nature and circumstances of financial institutions and risks assumed relative to other organizations.

Appendix 1 contains a description of the special nature of financial institutions.

THE UNIQUENESS OF CREDIT UNIONS

Credit unions are unique among financial institutions in terms of the cooperative principles that underpin their formation and impact their decision-making. Among these principles, democratic values, member accountability and community engagement are balanced with economic priorities to ensure a strong credit union. A credit union's democratic control structure can either create or reduce risk depending on the degree to which the members take an active interest in the safety, stability and sustainability of the organization as owners.

Boards should encourage members to engage with the credit union as owners by promoting disclosure. Engagement with members as owners can create goodwill, contributing to a stronger member bond and a more resilient credit union. When governing and setting the organization's strategic direction, boards are expected to consider the values represented by its members, and the impact the strategy may have on the Saskatchewan credit union system.

IV. THE ROLE OF THE BOARD OF DIRECTORS

The board plays a pivotal role in the success of a credit union through the approval of the organization's overall strategy and risk appetite, and its oversight of senior management and internal controls.

BOARD RESPONSIBILITIES

The board has overall responsibility for the credit union, including subsidiary operations. In addition to the roles and responsibilities of the board outlined in legislation, the board is responsible for approving, overseeing, periodically reviewing and assessing the implementation and effectiveness of the credit union's:

- corporate governance framework
- corporate mission, principles and values
- code of conduct and market code
- short-term and long-term enterprise-wide business strategy, objectives and plans (capital, financial, liquidity), including the enterprise risk management framework (ERM framework)
- business and financial performance as well as performance indicators relative to the business strategy and ERM framework
- significant strategic initiatives or transactions, such as mergers and acquisitions
- corporate policies for risk, risk management and compliance
- internal controls system
- compliance with applicable laws, the Standards and supporting Regulatory Guidance Documents
- appointment, performance review and compensation of the CEO and, where appropriate, other members of senior management and the heads of oversight functions
- succession plans with respect to the board, CEO and, where appropriate, other members of senior management and the heads of oversight functions
- mandate, resources and budgets for the oversight functions
- external audit plans, including audit fees and the scope of audit engagements
- disclosure policies and processes that support transparency to members and other stakeholders

These are the primary functions of the board, and should be the main focus of the board's attention and activities.

The board is responsible for reviewing and discussing regularly the credit union's:

- organizational structure
- compensation policy for all human resources
- significant operational and business policies

These functions are the responsibility of senior management. However, through careful review and discussion, the board has a critical role in providing high-level guidance and appropriate oversight of senior management with respect to these matters.

The board is expected to understand the decisions, plans and policies being undertaken by senior management and their potential impact on the credit union. It should probe, question and seek assurances from senior management that these are:

- consistent with the board-approved strategy, prudent and aligned with the risk appetite of the organization
- designed to incent behaviors and outcomes that are in the best interest of the credit union and its members

- aligned with internal constraints such as financial and operational capability, and external constraints such as competitive and economic conditions

The board should also be satisfied that the corresponding internal controls are sound and implemented in an effective manner. The board should establish processes to periodically assess the assurances provided to it by senior management.

While senior management should have regular interaction with the Corporation with respect to the overall operations of the credit union, the board is expected to notify the Corporation promptly of substantive issues affecting the organization.

Board Responsibilities of Credit Union Subsidiaries

Boards of credit unions are tasked with determining what board structures for the organization's subsidiaries would best contribute to effective oversight of subsidiary operations. Regardless of the composition of the boards of subsidiaries, credit union boards are required to exercise adequate oversight of the activities of subsidiaries to ensure that the credit union board can meet its responsibilities. This does not suggest that boards of subsidiary organizations should replicate all corporate governance activities of credit union boards, or that credit union boards should assume responsibility for the performance of specific duties of subsidiary boards.

Credit unions are expected to pay special attention to the performance, composition and activities of subsidiary boards, especially where:

- the activities of a subsidiary are significantly different or independent from the core business of the credit union
- special expertise is required to provide oversight of the subsidiary's activities
- there is the potential for conflicts of interest between the various stakeholders of the credit union and the subsidiary
- there is a need for close oversight of some activities of the subsidiary that, although perhaps not material by some measures, might give rise to reputational, legal or regulatory risks for the credit union
- the subsidiary operates in an industry that has substantially different regulatory requirements
- the subsidiary is involved in providing services to the general public and/or other entities

Board Effectiveness

An effective board should, through its collective expertise, skills, experiences and competencies, provide objective and thoughtful guidance to, and oversight of, senior management. Credit unions are expected to ensure that board composition reflects their membership and the communities they serve.

The hallmarks of an effective board and its directors include demonstrated sound judgement, initiative, responsiveness and operational excellence.

Judgement – The board is expected to make sound and well-informed decisions, taking into consideration the credit union's business objectives and risk appetite.

Initiative – The board is expected to exercise its responsibilities in a proactive and timely manner with a readiness to probe, challenge and provide appropriate guidance to senior management.

Responsiveness – The board is expected to be responsive to issues or deficiencies identified by itself (through internal board evaluations), senior management, the oversight functions or the Corporation, and to oversee the rectification of those issues or deficiencies.

Operational Excellence – The board is expected to have practices and processes that encourage open discussion, debate, and advance consideration of important credit union matters and transactions based on relevant and timely information. The board should periodically review the adequacy and frequency of the information needed in order for the board to fulfill its duties.

Board members are expected to demonstrate integrity by acting ethically, and respecting the confidentiality and solidarity of board decisions. Board members must also disclose real or perceived conflicts of interest, and act in the best interest of the credit union and its members at all times.

The board and board committees are expected to define appropriate governance policies and practices for its own work, and have in place the means to ensure that they are followed and periodically reviewed for ongoing improvement. The board should exemplify sound governance principles through its own work. These practices help the board carry out its duties more effectively. At the same time, they send important signals internally and externally about the kind of organization the credit union is and aims to be.

The board is expected to regularly conduct a self-assessment of the effectiveness of board and board committee policies and practices, occasionally with the assistance of independent external advisors. The scope and frequency of such external input should be established by the board.

Board Independence

While the board is expected to build and foster mutual trust with the CEO and senior management team, the board must act independently from the CEO and senior management. It is important that the board's behavior and decision-making process be objective and effective, taking into account the particular circumstances of the credit union. The board's ability to act independently of senior management can be demonstrated through practices such as having regularly scheduled in-camera board and board committee meetings, and by demonstrating a willingness to ask questions and challenge assumptions.

The recruitment process for new directors and the development of a director profile are both responsibilities of the board, and should emphasize the independence of board members from senior management. Where appropriate, director tenure may also be an issue when considering board independence, and factored into policy.

Board Skills and Competencies

While the Corporation expects all directors to play an effective role, it is recognized that the contribution of individual directors will vary based on their particular qualifications and experience. Collectively, however, the board is expected to bring a balance of expertise, skills, experience and perspectives, taking into consideration the credit union's strategy, risk profile and overall operations. Relevant financial industry and risk management expertise are key competencies for the credit union board. The Corporation expects a reasonable representation of these skills at the board and board committee levels.

In order to assess the skills and competencies required to oversee the credit union's strategy, products and risks, boards are expected to have a skills and competency evaluation process. The process should be reviewed annually and updated by the board or appropriate board committee. The skills and competency evaluation process should be integrated with the overall board succession or board renewal plans, with particular attention to the positions of the board chair and chairs of board committees. Boards are expected to communicate the necessary skills and qualities required in advance of the election process, and actively recruit candidates with the necessary skills and qualities to run for board membership.

Directors are expected to seek educational opportunities to increase their knowledge and expertise so that they can fully understand the business and risks undertaken by the credit union, as well as developments in corporate and risk governance practices. Where the board or a committee determines that it does not have the appropriate knowledge, expertise or experience to fully evaluate risks, it should seek advice or analysis from expert advisors. This may include obtaining services from consultants, or, if the credit union's bylaws allow, the appointment of non-members of the board to a committee.

Board Chair

An effective board requires a chair that is experienced, skillful and exhibits leadership that encourages open discussion and debate. The chair is expected to spend more time in the role than is required of other board members. The chair should have frequent dialogue with, and a strong level of influence among, other board members, the CEO and senior management, as well as access to credit union information and staff. Given the critical position of the chair among board members, he/she is also expected to foster direct and ongoing dialogue with the Corporation.

Board Committees

To increase efficiency and allow deeper focus in specific areas, boards are required to establish specialized board committees. The number and nature of committees depends on many factors, including the size of the credit union and its board, the nature of the business areas of the organization and its risk profile. Credit unions are required by legislation to have an audit committee[1] and a conduct review committee[2], and the Corporation expects credit unions to have a risk committee. In addition to these committees, credit unions may choose to establish other board committees, including:

Compensation committee – the compensation committee oversees the compensation system's design and operation, and ensures that compensation is appropriate and consistent with the credit union's culture, long-term business and risk strategy, performance and control environment, as well as legal and regulatory requirements.

Nominations/human resources/governance committee - provides recommendations to the board for new board members. Members of this committee may be involved in the

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[1] Where the board fails to appoint an audit committee, the board shall act as the audit committee.

[2] Where the board fails to appoint a conduct review committee, the board shall act as the conduct review committee.

assessment of board and senior management effectiveness, and in overseeing the credit union's governance and human resource policies and processes.

Ethics/compliance committee - focuses on ensuring that the credit union has the appropriate means for promoting proper decision making and compliance with laws, regulations and internal rules, and provides oversight of the compliance function.

Other committees – credit unions may establish other committees and provide them with the mandate to undertake specific tasks.

The role of the audit and risk committees is discussed later in this guideline.

Board consideration of risk-related issues may be enhanced by members serving on more than one committee, subject to constraints on the directors' time. For example, a member who serves on the compensation committee while also serving on either the risk or audit committee may have a greater appreciation of risk considerations in these areas.

Like the board, each committee is expected to have a charter or other instrument that sets out its mandate, scope and working procedures. To avoid undue concentration of power and to promote fresh perspectives, it is useful to rotate the chair and membership of board committees provided that doing so does not impair the collective skills, experience and effectiveness of the committees.

INTERFACE BETWEEN THE BOARD AND SENIOR MANAGEMENT

The board's primary interface with senior management is through the CEO. As well, the board or individual board members should meet regularly with other members of senior management and the heads of oversight functions with and without other members of senior management present.

The CEO and other members of senior management are responsible for directing and overseeing the effective management of the credit union. Senior management is responsible for delegating duties to staff, and for establishing a management structure that promotes accountability and transparency. It is important that senior management remains cognizant of its obligation to oversee delegated responsibilities and activities, and of its ultimate responsibility to the board for the performance of the credit union. In this regard, the skills, competence, integrity and experience of senior management are critical factors in the safety and soundness of the credit union.

To fulfill its responsibilities, the board relies on senior management to provide it with sound advice on the organizational objectives, strategy, structure and policies of the credit union. Senior management is expected to set out and analyze options for the board, identify potential trade-offs of each option, and make and support recommendations. Senior management and the board should work together to ensure that the information and material presented to the board is relevant, and packaged in a manner that enables the board to focus on key issues and make informed decisions.

Senior management facilitates the board's oversight role by providing relevant, accurate and timely information to the board. This enables the board to oversee the management and operations of the credit union, assess policies, and determine whether the organization is achieving its objectives and operating in an appropriate control environment. Senior management is expected to provide assurances to the board that policies, processes and controls are adequate and operating appropriately, and that risk is appropriately controlled and consistent with the credit union's market code and code of conduct.

The board and CEO are expected to ensure that the oversight functions have the resources and support to fulfill their duties, and the expertise/capacity to offer objective opinions and advice to the board and senior management.

INTERFACE BETWEEN THE BOARD AND THE OVERSIGHT FUNCTIONS

The Corporation expects credit unions to establish independent oversight functions. The size and sophistication of the oversight functions may vary based on the size, nature, scope and complexity of business operations, and the risks inherent to the organization. A board will often oversee the credit union's oversight functions through an appropriate committee, such as the audit committee or risk committee.

The heads of the oversight functions must have sufficient stature and authority within the organization and be independent from operational management. They should have unfettered access and, for functional purposes, a direct reporting line to the board or the relevant board committee (e.g., audit, risk).

In order to fulfill its duties, the board relies on the objective advice of the oversight functions. These functions help the board to fulfill its role of stewardship and oversight of the credit union's operations by validating whether its controls are effective and whether the organization's operations, results and risk exposures are reliably reported. To be effective, the oversight functions must provide objective assessments.

The board is expected to approve the mandate, resources (amount and type) and budgets of the oversight functions, and where appropriate, the appointment, performance review and compensation of the heads of these functions. The board is expected to review and discuss the findings and reports produced by the oversight functions, understand how material disagreements are being addressed, follow-up on any concerns or findings being raised and track senior management's action plans.

In small, less complex credit unions, rather than establishing specific oversight functions, the Corporation expects that the board and senior management will ensure that other functions or processes, within or external to the credit union, provide the level of compensating controls and independent enterprise-wide oversight required. For these organizations, it is useful to focus on the principles of independence, rather than the structure, to maximize functional independence.

The board is expected to regularly assess the effectiveness of the credit union's oversight functions and processes. Occasionally, as part of its assessment, the board should conduct a benchmarking analysis of those functions and processes with the assistance of independent external advisors. The scope and frequency of such external input should be established by the board.

BOARD OVERSIGHT OF INTERNAL CONTROLS

A credit union's internal control framework (internal controls) encompasses all the personnel, policies, processes, limits, culture and other aspects of a credit union that support the achievement of the organization's objectives. It facilitates the efficiency of operations, contributes to effective risk management, assists compliance with applicable laws and regulations, and strengthens the credit union's capacity to respond appropriately to business opportunities and challenges.

The board is expected to approve the overall internal control framework and monitor its effectiveness. The board should receive regular reports on the general operations of the credit union and its financial condition, the performance of risk management and other control systems, and any ineffectiveness or significant breaches of these controls, the organization's code of conduct, or laws and regulations.

As a part of the evaluation of the adequacy and effectiveness of credit union internal controls (for the credit union as a whole and for individual business activities), the board can use internal and external audit reports, actuarial reports (if applicable) and the Corporation's opinion on the financial condition of the credit union.

The board is expected to seek assurances from senior management that prompt action is being taken to correct any material internal control deficiencies or breaches, and that there is a process in place to monitor and report on the progress made to correct such deficiencies. The board, along with senior management, should also proactively consider whether deficiencies identified in one area of the credit union's operations may also be present in other areas.

V. RISK GOVERNANCE

GENERAL

Risk taking is a necessary part of a financial institutions' business. Credit unions' strategies incorporate decisions regarding the risks the organization is willing to undertake and the means with which it will manage and mitigate those risks.

Risk governance is a distinct and crucial element of corporate governance of credit unions. Risks may arise from direct exposure or through exposures taken by subsidiaries. Credit unions should be able to identify the significant risks they face, assess their potential impact, and have policies and controls in place to effectively manage them.

ENTERPRISE RISK MANAGEMENT FRAMEWORK

Credit unions are expected to have a board-approved ERM framework that guides the risk-taking activities of the credit union. The framework is to be enterprise-wide and tailored to the organization's business activities and operations. The ERM framework should be well-understood throughout the organization and embedded within the culture of the credit union. All operational, financial and corporate policies, practices and procedures of the credit union should support the ERM framework.

The ERM framework sets basic goals, benchmarks, parameters and limits (e.g., level of losses) as to the amount of risk a credit union is willing to accept, taking into account various financial, operational and macroeconomic factors. It also considers the material risks to the credit union, as well as the organization's reputation among depositors, stakeholders and the general public.

The ERM framework is expected to be forward-looking and consistent with the credit union's business model and strategy, and the board's capability to understand and oversee the organization's risks. An effective framework should also be aligned with the organization's principles and values, overall philosophy, capital plan, financial plan, business objectives, corporate policies, code of conduct, market code and risk mitigation strategy. It is intended to provide boundaries on the ongoing operations of a credit union with respect to asset class and liability choices, and participation in activities that are not consistent with the stated risk appetite of the organization.

The establishment of controls and a process to ensure their effectiveness are critical elements of the ERM framework, as they help to ensure that the credit union stays within the risk boundaries set by the board.

Appendix 2 contains additional details about the ERM framework.

OVERSIGHT OF RISK

Risk management systems and practices will differ, depending on the size, nature, scope and complexity of business operations, and the risk exposures of the credit union. To manage risks effectively, credit union boards and senior management need to have a full understanding of the risks inherent to the credit union's business model, including each business line and product, and how they relate to the credit union's strategy and ERM framework.

Senior management is expected to oversee regular reviews of risk management policies and practices to ensure that they remain appropriate and effective in light of changing circumstances and risks. The board is expected to seek assurances from senior management that these controls are operating effectively and should establish processes to periodically assess the assurances provided to it.

Board Risk Committee

Depending on the nature, size, complexity and risk profile of the credit union, the board should establish a dedicated risk committee to oversee risk management on an organization-wide basis. In lieu of establishing a separate risk committee, the boards of smaller, less complex credit unions must ensure that they have the collective skills, time and information to provide effective oversight of risk management across the credit union. Many credit unions choose to combine the risk committee and audit committee functions. Those that do may wish to create separate agenda items by topic to ensure neither perspective gets overlooked.

Guided by the credit union's ERM framework, the risk committee is expected to have a sound understanding of the types of risks to which the credit union may be exposed and the techniques and systems used to identify, measure, monitor, report on and mitigate those risks.

The risk committee is expected to have a clear mandate, with an adequate number of committee members having sufficient knowledge of risk management in financial institutions. Where appropriate, the committee should include individuals with technical knowledge in risk disciplines that are significant to the credit union.

As part of its duties to oversee risk management of the credit union, the risk committee is expected to seek assurances from the CRO (or equivalent) that the oversight of the risk management activities of the credit union are independent from operational management, adequately resourced, and have appropriate status and visibility throughout the organization.

The risk committee is expected to receive timely and accurate reports on significant risks of the credit union and exposures relative to the organization's risk appetite and risk limits. It should provide input to the approval of material changes to the credit union's strategy and corresponding risk appetite. As well, the risk committee needs to be satisfied with the manner in which material exceptions to policies and controls are identified, monitored, measured and controlled, as well as the remedial actions when exceptions/breaches are identified.

Chief Risk Officer

Credit unions are expected to appoint a senior officer with responsibility for the oversight of all relevant risks across the organization (CRO or equivalent). The CRO needs to have sufficient stature and authority within the organization, and be independent from operational management. The CRO is expected to have unfettered access and, for functional purposes, a direct reporting line to the board or the risk committee.

For smaller, less complex credit unions, the CRO role can be held by another executive of the credit union (i.e., the executive has dual roles). Some credit unions may not have a CRO position *per se*, but nonetheless can clearly identify an individual within the organization who is accountable to the board and senior management for the same functions.

The CRO is the head of the credit union's risk management function. The CRO and the risk management function are responsible for identifying, measuring, monitoring and reporting on the risks of a credit union on an enterprise-wide and disaggregated level, independently of the business lines or operational management.

The CRO and risk management function should not be directly involved in revenue-generation or in the management and financial performance of any business line or product of the credit union. As well, the CRO's compensation should not be linked to the performance (e.g., revenue generation) of specific business lines of the organization.

While the CRO and the risk management function will influence the credit union's risk-taking activities (e.g., to ensure that the credit union's strategy or business initiative is operating within the stated risk appetite of the organization), the ongoing assessment of risk-taking activities by the CRO and risk management function is expected to remain objective.

The CRO is expected to provide regular reports to the board, the risk committee and senior management in a manner and format that allows them to clearly understand the risks being assumed by the credit union. The CRO provides an objective view to the risk committee and the board on whether the credit union is operating within the ERM framework. The CRO is expected to meet with the risk committee or the board on a regular basis, with and without the CEO or other members of senior management present.

The CRO and risk management function are expected to have processes and controls in place to assess the accuracy of any risk information or analysis provided by business units in order to be in a position to offer objective reporting to the board, the risk committee and senior management. The board and the risk committee should periodically seek assurances from the CRO and risk management function as to the objectivity of such risk information and analysis.

VI. THE ROLE OF THE AUDIT COMMITTEE

The statutory duties, key principles and requirements of the audit committee are outlined in legislation and the Standards. They include, among other things, reviewing the annual statements of the credit union, ensuring the scope of audit plans are appropriate, and meeting with the chief internal auditor (or designate) and management to review and discuss the effectiveness of the organization's risk management, internal control and governance processes. The committee needs to ensure their actions are reported to the entire board at regular intervals and that issues requiring full board attention are elevated when necessary.

The audit committee is responsible to review and approve the credit union's audit plans (internal and external) to ensure that they are appropriate, risk-based and address all the relevant activities over a measurable cycle, and that the work of internal and external auditors is coordinated. Where part or all of the internal audit function is outsourced, the board maintains responsibility to oversee the performance of the credit union's internal audit as a whole.

The audit committee is responsible to recommend to the board the appointment, reappointment, removal and remuneration of the external auditor, and also to agree to the scope and terms of the audit engagement and approve the engagement letter. The audit committee should satisfy itself that the level of the audit fees is commensurate with the scope of work undertaken. The audit committee is also expected to assess whether any change to the external auditor's materiality level and/or proposed scope continues to ensure a quality audit.

The audit committee is expected to assess the skills, resources (amount and type) and independence of the external auditor, including the audit firm's internal policies and practices for quality control, and be satisfied with the content of the auditor's engagement letter prior to it being signed. The audit committee is expected to have in place a governance framework to address any concerns raised by the Corporation or other stakeholders about the external auditor's independence.

The audit committee also establishes criteria for the types of non-audit services that an external auditor can and cannot provide, including rules stipulating when advance approval by the audit committee is required for new contracts.

A credit union's audit committee is responsible to assess whether the organization's accounting practices are appropriate and within the bounds of acceptable practice. The audit committee is expected to receive all substantive correspondence between the external auditor and senior management related to its audit findings.

The audit committee is expected to probe, question and hold regular in-camera meetings with the external auditor and the chief internal auditor (or equivalent) to understand all of the relevant issues and how these issues have been resolved.

The audit committee is expected to discuss with senior management and the external auditor the overall results of the audit, the financial statements and related documents, the audit report, the quality of the financial statements and any related concerns raised by the external auditor. This should include, but not be limited to:

- key areas of risk for material misstatement of the financial statements, including critical accounting estimates or areas of measurement uncertainty

- areas of significant auditor judgement, including accounting policies, accounting estimates and financial statement disclosures
- whether the external auditor considers estimates/models to be aggressive or conservative within an acceptable range and, specifically, where there are options, the rationale for the final valuation decision and if the option is consistent with industry practice
- significant or unusual transactions (e.g., restatements)
- difficult or contentious matters noted during the audit or other audit matters that would typically be discussed with an engagement quality control reviewer
- changes in the audit scope or strategy
- internal control deficiencies identified during the course of the audit
- areas of financial statement disclosures that could be improved

The audit committee is expected to probe, question and seek assurances from the external auditor that the financial statements present fairly the financial position, the results of operations and the cash flows of the credit union. The audit committee is required to review the performance of the external auditor, and to provide a report on the effectiveness of the external auditor to the board on an annual basis.

VII. DISCLOSURE

The board is required to ensure that the credit union's disclosures are adequately transparent and include the main aspects of their governance programs. Disclosures should enable members and other stakeholders to understand the credit union's governance structure.

VIII. SUPERVISION OF CREDIT UNIONS

THE ROLE OF CORPORATE GOVERNANCE IN THE CORPORATION'S SUPERVISORY PROCESS

Effective corporate governance is an essential element in the safe and sound functioning of credit unions. The board and senior management are designated as key oversight functions in the Corporation's risk-based supervisory framework.

Effective oversight of the business and affairs of a credit union by its board and senior management is essential to the maintenance of an efficient and cost-effective supervisory system. It helps protect depositors and allows the Corporation to use the work of the credit union's internal processes and functions, thereby reducing the amount of supervisory resources required for the Corporation to meet its mandate.

In addition, in situations where a credit union is experiencing problems, or where significant corrective action is necessary, the important role of the board is heightened. The Corporation requires significant board involvement in seeking solutions and overseeing the implementation of corrective actions.

THE CORPORATION'S SUPERVISORY ASSESSMENT

The Corporation supervises credit unions to assess their condition and monitor compliance with all applicable requirements. Through the risk-based supervisory framework, the Corporation has set out a comprehensive set of assessment criteria. Key among the assessment criteria is the quality of oversight and control provided by the board and senior management.

The Corporation conducts supervisory work and monitors the performance of credit unions to assess safety and soundness, the quality of control and governance processes and regulatory compliance. The board and senior management are ultimately accountable for the safety and soundness of the credit union, as well as its compliance with governing legislation and all other requirements. As such, the Corporation's reports and findings can provide useful input to the board's own oversight of the credit union. Open communication between the board and the Corporation helps promote the mutual trust and confidence essential to the efficiency of the principles-based system of supervision the Corporation follows.

A board that carries out its responsibilities effectively will understand the regulatory environment within which the credit union and its subsidiaries operate, and be informed of the results of the Corporation's supervisory work. The board is expected to follow-up accordingly on the recommendations or findings identified by the Corporation, as well as senior management's action plans to address regulatory matters, and discuss with senior management to determine if weaknesses found are broader indicators that similar problems may exist elsewhere in the organization.

A credit union board is expected to consider regulatory findings in its ongoing evaluation of senior management and oversight function performance, recognizing that primary responsibility for identifying weaknesses rests with the board and senior management.

The Corporation will continue to undertake a number of approaches, including discussions with the board, board committees, senior management and oversight functions, as well as the review of board and board committee material in order to assess the effectiveness of the credit union's corporate governance processes. The Corporation will seek evidence that processes exist and are operating effectively, and that the board is able to fulfil its roles and responsibilities.

Where separate oversight functions do not exist, the Corporation will look to other functions, processes or controls to assess the independent oversight provided.

CHANGES TO THE BOARD AND SENIOR MANAGEMENT

As part of the ongoing supervisory process, credit unions are expected to notify the Corporation of any changes to the membership of the credit union board and senior management, and any circumstances that may adversely affect the suitability of board members and senior management.

APPENDIX 1 – THE SPECIAL NATURE OF FINANCIAL INSTITUTIONS

A number of factors set financial institutions apart from other business firms, and has led them to be subject to generally higher levels of regulation, including:

- the effectiveness of the economy depends significantly on how well the financial services sector functions. Relative to non-financial businesses, the failure of a financial institution can have a greater impact on members who may have placed a substantial portion of their life savings with a credit union or other financial institution and who may rely on the organization for day-to-day financial needs. There is also potential in some circumstances for system-wide impacts from failures or material impacts in selected markets, given the interconnectedness of the financial system. Safety and soundness concerns are, therefore, of particular importance for financial institutions.
- financial institutions may have high ratios of debt-to-equity, making them more vulnerable to unexpected adverse events
- financial institutions can experience severe liquidity problems if depositors or the public lose confidence in their safety and soundness
- financial institutions may accept funds from the public and often deal in long-term financial commitments, which are predicated on a high degree of confidence in the long-term stability and soundness of the institutions making these commitments
- the value of many financial institutions' assets and liabilities can be volatile and may be difficult to price accurately
- financial institutions can have large mismatches between the term of their assets and liabilities. This can result in material funding or investment risks.

These characteristics create unique challenges for the governance of financial institutions and underscore the importance of effective risk management systems and rigorous internal controls. They point to the need for knowledgeable, independent oversight exercised by or on behalf of the board, along with the additional assurance of regulatory oversight, to provide assurance to members and other stakeholders on the reliability of reporting and disclosure. Also, being a regulated industry, the governance processes of financial institutions are subject to review and may be influenced by the views of regulatory bodies.

Finally, some financial institutions have more complex organizational structures with subsidiaries. For these organizations, the relationship between the financial institution and its subsidiaries merits special consideration and the effective governance of subsidiaries should be a high priority for directors and senior management.

APPENDIX 2 – ENTERPRISE RISK MANAGEMENT FRAMEWORK

The ERM framework is expected to contain a risk appetite statement and risk limits, as well as an outline of the roles and responsibilities of those overseeing the implementation of the ERM framework. The Corporation expects credit unions to review the framework regularly and to ensure it is updated as necessary to reflect changes in risk appetite or strategy.

RISK APPETITE STATEMENT

The risk appetite statement should be forward-looking, and reflect the aggregate level and type of risk that a credit union is willing to accept in order to achieve its business objectives. It should also consider normal and stressed scenarios, and align with the credit union's risk capacity and regulatory constraints. Key features of the risk appetite statement include:

- linkage to the organization's short-term and long-term strategic, capital and financial plans, as well as compensation programs
- consideration of internal constraints such as financial and operational capability and external constraints such as competitive and economic conditions
- inclusion of qualitative and quantitative measures that can be aggregated and disaggregated
  - qualitative measures may include:
    - an inventory and description of the credit union's risk exposures and discussion of their interconnectedness
    - significant risks the organization wants to take and why
    - significant risks the organization wants to avoid and why
    - attitude towards regulatory compliance
    - underlying assumptions and risks
  - quantitative measures may include:
    - measures of loss or negative events (such as earnings, capital and liquidity) that the credit union is willing to accept

The risk appetite statement provides tolerances and boundaries to the strategic planning and ongoing operations of a credit union, and drives the credit union's culture by embedding itself in functions and business activities at all levels.

RISK LIMITS

Risk limits are the allocation of the credit union's risk appetite statement to:

- specific risk categories (e.g., credit, market, insurance, liquidity, operational)
- the business unit level (e.g., retail, commercial)
- lines of business or product level (e.g., concentration limits)
- more granular levels, as appropriate

Risk limits are often expressed in quantitative terms, and are specific, measurable, frequency-based and reportable. They are expected to be aligned with board-approved policies.

IMPLEMENTATION OF THE ERM FRAMEWORK

Once approved by the board, the ERM framework is to be implemented by senior management throughout the organization as an integral part of the overall enterprise risk management framework of the credit union. The ERM framework needs to align with the credit union's corporate strategy, financial and capital plans, business unit strategies and day-to-day operations, risk management policies (e.g., risk limits, risk selection/ underwriting guidelines and criteria) and compensation programs.

Where the ERM framework sets aggregate limits that will be shared among different units, the basis on which such limits will be shared should be clearly identified and communicated.

Credit unions are expected to develop effective control, monitoring and reporting systems and procedures to ensure ongoing operational compliance with the ERM framework, including the following:

- the CRO (or equivalent) is expected to ensure that aggregate risk limits are consistent with the credit union's risk appetite statement
- the CRO (or equivalent) is expected to include in regular reports to the board or risk committee, and senior management, an assessment against the risk appetite statement and risk limits
- internal audit is expected to routinely assess compliance with the ERM framework on an organization-wide basis and in its review of units within a credit union

The board and senior management of a credit union are expected to receive regular reports on the effectiveness of, and compliance with, the ERM framework. These reports should include a comparison of actual results versus stated ERM framework measures. Where breaches are identified, action plans are to be communicated to the board. The ERM framework should be an integral part of the board's discussions and decision-making processes.