REGULATORY GUIDELINE AND PRUDENTIAL STANDARD

# Corporate Governance

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# I. PURPOSE AND SCOPE

For SaskCentral, pursuant to Part XIII of *The Credit Union Central of Saskatchewan Act, 2016* (the Act), Credit Union Deposit Guarantee Corporation (the Corporation) may make Prudential Standards that apply to SaskCentral. The Prudential Standard (Standard) contained herein must be adhered to by SaskCentral.

For credit unions, this is a Regulatory Guidance Document (Guideline) 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.

The purpose of this Guideline and Standard is to communicate key principles and the expectations of the Corporation with respect to corporate governance.

> The Corporation's expectations for corporate governance are principles-based and recognize that an institution's corporate governance practices may depend on its nature, scope, complexity of operations and risk profile.
>
> The Corporation expects the board and senior management to be proactive and aware of best practices related to corporate governance that are applicable to their institution. Where appropriate, the institution is expected to adopt these best practices.

# II. CORPORATE GOVERNANCE

## DEFINING CORPORATE GOVERNANCE

Corporate governance is defined as a set of relationships between an organization's management, board[1], members, shareholders, and other stakeholders. "Corporate governance also provides the structure through which the objectives of the organization are set, and the means of attaining those objectives and monitoring performance are determined"[2].

Appropriate organizational structures, policies and other controls help promote, but do not ensure, good corporate governance. Governance lapses can still occur through undesirable behaviour and corporate values. Effective corporate governance is not only the result of "hard" structural elements, but also "soft" behavioural factors driven by dedicated directors and management performing faithfully their duty of care and duty of loyalty to the organization. A demonstrated corporate culture that supports and provides appropriate norms and incentives for professional and responsible behaviour 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.

[1] In this Guideline and Standard, 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.

[2] See OECD Principles of Corporate Governance, revised in 2015.

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 UNIQUENESS OF FINANCIAL INSTITUTIONS

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

Credit unions and SaskCentral 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 organization. The 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 institution as owners.

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

## III. THE ROLE OF THE BOARD OF DIRECTORS

The board is accountable for the institution's business plan, strategy, risk appetite and culture. The board oversees senior management and internal controls.

### BOARD RESPONSIBILITIES

The board has overall responsibility for the institution, including subsidiary operations. In addition to the roles and responsibilities of the board outlined in legislation, the board is expected to discharge, at a minimum, the following essential duties:

**1) Approve and Oversee:**

*Strategy*
- short-term and long-term business plan and strategy
- significant strategic initiatives or transactions, (e.g., mergers and acquisitions)

*Risk Management*
- Enterprise Risk Management (ERM) framework[3]
- internal control framework
- significant operational, business, risk and crisis management policies of the institution, including those in respect of credit, market, operational, insurance, regulatory compliance and strategic risks, and their effectiveness
- significant policies, plans, and strategic initiatives related to the management of, or that materially impact, capital and liquidity (e.g., internal capital targets, liquidity targets)

[3] Refer to Appendix 2 for a description of the ERM framework.

- disclosure policies and processes that support transparency to members and other stakeholders
- code of conduct and market code[4]
- compliance with applicable laws, regulations, the Standards of Sound Business Practice and Prudential Standards, and supporting guidance

*Board, Senior Management, and Oversight Functions*

- appointment, performance review and compensation of the Chief Executive Officer (CEO) and, where appropriate, other members of senior management, including the heads of oversight functions
- succession plans with respect to the board, CEO and, where appropriate, other members of senior management, including the heads of the oversight functions
- mandate, resources and budgets for the oversight functions
- compensation system

*Audit Plans*

- external audit plan, including audit fees and the scope of the audit engagement
- internal audit plan

The duties above are the primary responsibilities of the board, and should be the main focus of the board's attention and activities. The board is not responsible for the ongoing and detailed operationalization of its decisions; this is the responsibility of senior management.

**2) Provide challenge, advice and guidance to the senior management of the institution, as appropriate on:**

*Business Performance and Effectiveness of Risk Management*

- performance of the institution relative to the board-approved business plan and strategy
- effectiveness of the ERM framework
- effectiveness of the internal control framework
- effectiveness of the oversight functions
- effectiveness of significant policies and plans related to management of capital and liquidity (e.g., stress testing, ICAAP)

The duties above are the responsibility of senior management. The board has the discretion to decide the extent and nature of its input, and to provide challenge, advice and guidance on these matters and others.

The board is expected to be satisfied that the decisions and actions of senior management are consistent with the board-approved business plan, strategy and risk appetite of the institution and that the corresponding internal controls are sound.

[4] Market code is not applicable for SaskCentral.

## The Board and Senior Management

Senior management is responsible for implementing the board's decisions and directing the operations of the institution.

Senior management is composed of the CEO and individuals who are directly accountable to the CEO. This can include the heads of the oversight functions, such as the Chief Financial Officer (CFO), Chief Risk Officer (CRO), Chief Compliance Officer (CCO), and Chief Internal Auditor (CIA), as well as the heads of major business platforms or units.

Senior management is responsible for implementing the board's decisions and directing the operations of the institution within the authority delegated to them by the board, and in compliance with applicable laws, regulations, standards, and guidelines. It is important that senior management remains aware of its obligation to oversee delegated responsibilities and activities, and of its ultimate responsibility to the board for the performance of the institution. In this regard, the skills, competence, integrity and experience of senior management are critical factors in the safety and soundness of the institution.

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 institution. Senior management is expected to set out information, options, potential trade-offs, and recommendations that enables the board to focus on key issues and make informed decisions in a timely manner.

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

- consistent with the board-approved strategy and risk appetite for the institution
- designed to incent behaviours and outcomes that are in the best interest of the institution, its members and stakeholders
- aligned with internal constraints, such as financial and operational capability, and external constraints such as competitive and economic conditions
- in compliance with all applicable regulatory requirements

The board should establish processes to periodically assess the assurances provided to it by senior management.

## The Board and Oversight Functions

The Corporation expects the institution to establish oversight functions that are independent from business line management[5]. The size and sophistication of the oversight functions may vary based on the nature, scope and complexity of business operations and the risks inherent to the organization. The board will often oversee the institution's oversight functions through an appropriate committee, such as the audit committee or risk committee.

The oversight functions provide objective assessments to the directors to allow them to fulfill their responsibilities. The oversight functions identify, measure and report on the

[5] As defined in the Corporation's Supervisory Framework, "business line management" is responsible for planning, directing and controlling the day-to-day operations of specific business activities. The oversight functions are "independent" of business line management.

institution's risks, assess the effectiveness of risk management and internal controls, and determine whether the operations, results and risk exposures are consistent with the risk appetite of the organization. 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.

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

In the absence of specific oversight functions, the Corporation expects that the board and senior management will ensure that other functions or processes, within or external to the organization, provide the level of compensating controls and independent enterprise-wide oversight required. In these instances, 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 institution'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.

## The Board and Internal Audit

The internal audit function is responsible for conducting risk-based and general audits and reviews to provide assurance to the board that the overall governance framework is effective and that policies and processes are in place and consistently applied. The internal audit function is accountable to the board and the audit committee on all matters related to the performance of its mandate as described in the internal audit charter. It must be independent of the audited activities and have sufficient standing, authority and resources within the institution to enable the auditors to carry out their assignments effectively and objectively.

The board and the audit committee should respect and promote the independence of the internal audit function by:

- ensuring that internal audit reports are provided to the board without management filtering
- requiring timely and effective correction of audit issues by senior management
- requiring internal audit to conduct a periodic assessment of the institution's overall risk governance framework including, but not limited to, an assessment of:
  - the effectiveness of the risk management and compliance functions
  - the quality of risk reporting to the board, board committees and senior management
  - the effectiveness of the system of internal controls

## The Board and Subsidiaries

In a group structure with subsidiaries, in which the institution is the parent company, the board of the institution has the overall responsibility for the group. This involves ensuring the establishment and operation of a clear governance framework that is appropriate to the structure, business and risks of the group and its entities.

In operating within a group structure, the board and senior management of the parent company are expected to be aware of the material risks and issues that might affect both the institution as a whole and its subsidiaries. There needs to be adequate oversight over subsidiaries while respecting the independent legal and governance responsibilities that might apply to subsidiary boards.

In order to fulfill its responsibilities, the board of the parent company is expected to:

- establish a group structure (including the legal entity and business structure) and a corporate governance framework with clearly defined roles and responsibilities. This includes those at the parent company level and at the subsidiary level, as may be appropriate based on the size and complexity of the subsidiary.
- define an appropriate subsidiary board and management structure which takes into account the material risks to which the group, its businesses and its subsidiaries are exposed
- assess whether the group's corporate governance framework includes adequate policies, processes and controls and whether the framework addresses risk management across the businesses and legal entity structures
- ensure that the group's corporate governance framework includes appropriate processes and controls to identify and address potential intragroup conflicts of interest, such as those arising from intragroup transactions
- approve policies and clear strategies for establishing new structures and legal entities, and ensure that they are consistent with the policies and interests of the group
- assess whether there are effective systems in place to facilitate the exchange of information among the various entities, to manage the risks of the separate subsidiaries or group entities as well as of the group as a whole, and to ensure effective supervision of the group
- have sufficient resources to monitor the compliance of subsidiaries with all applicable legal, regulatory and governance requirements

## BOARD EFFECTIVENESS

The hallmarks of an effective board, and its directors, include demonstrated sound judgement, initiative, pro-activeness, responsiveness and operational excellence. Board members should strive to facilitate open communication, collaboration and appropriate debate in the decision-making process.

> The board is expected to regularly assess its practices, and those of the board committees, and should pursue strategies to enhance its overall effectiveness.

### Board Skills and Competencies

The board should be diverse and, collectively, bring a balance of expertise, skills, experience and perspectives, taking into consideration the institution's strategy, risk profile, culture and overall operations. Relevant financial industry and risk management expertise are key competencies for the institution's board. There should be reasonable representation of these skills at the board and board committee levels.

The board is expected to have a skills and competency evaluation process that is integrated with the overall board succession or board renewal plans and that pays particular attention to the positions of the chair of the board and chairs of the 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 in order to fully understand the business and risks undertaken by the institution, as well as to gain insight into 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 the appointment of non-members of the board to a committee if allowed by the institution's bylaws and legislation.

## Board Independence

The board, collectively, must be independent[6] from the CEO, senior management, and the operations of the institution. Achieving independence can involve various board structures and processes. Regardless of the approach, in all situations, the Corporation views the separation of the chair and CEO as critical. It is important that the board's behaviour and decision-making processes are objective and effective, taking into account the particular circumstances of the institution.

The board's ability to act independently of senior management can be demonstrated through practices such as having regularly scheduled board and board committee meetings that include sessions without senior management present.

Board members must also exhibit a duty of loyalty to the institution, by acting in good faith in the interest of the organization. Duty of loyalty should prevent individual board members from acting in their own self-interest, or in the interest of another individual or group, at the expense of the institution.

To promote independence of thinking, the board is expected to have a director independence policy that considers, among other factors, director tenure. For SaskCentral, this also needs to include the specific shareholder/ownership structure of the organization. The recruitment process for new directors and the development of a director profile (both responsibilities of the board) should emphasize the independence of board members from senior management.

## Board and Board Committee Chairs

> Board and board committee chairs should be independent, non-executive directors, as this is critical in maintaining the board's independence and its ability to execute its mandate effectively.

Effective boards and board committees require a chair that is experienced, skillful and exhibits leadership that encourages open discussion and appropriate debate. The chair of the board and the chairs of board committees 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 all the information and staff of the institution. Given the critical position of

[6] A board member is considered independent if they have no direct or indirect material relationship with the CEO, senior management, or operations of the institution. For the purposes of this guideline, a "material relationship" is a relationship which could, in the view of the board of directors, be reasonably expected to interfere with the exercise of a board member's independent judgement.

the chair among board members, this individual is also expected to foster direct and ongoing dialogue with the Corporation.

**Board Committees**

To increase efficiency and allow deeper focus in specific areas, the board is required to establish specialized board committees. The number and nature of committees depends on many different factors, including the size of the board, the business areas of the organization and its risk profile. At a minimum, the institution's board is expected to have an audit committee, conduct review committee and a risk committee[7].

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.

# IV. RISK GOVERNANCE

> Consistent with their specific roles and responsibilities and through their behaviours, actions and words, the board and senior management should promote a risk culture that stresses integrity and effective risk management throughout the institution.

## GENERAL

Risk taking is a necessary part of a financial institution's business. Accordingly, business strategies incorporate decisions regarding the risks the organization is willing to undertake and how it will manage and mitigate those risks.

Risk governance is a distinct and crucial element of corporate governance of the institution. Risks may arise from direct exposure taken by the institution, subsidiaries, affiliates or counterparties, or indirectly through activities that create risks to the institution's reputation. It is necessary for the institution to be in a position to identify the significant risks it faces, assess their potential impact and have policies and controls in place to manage them effectively.

## ENTERPRISE RISK MANAGEMENT FRAMEWORK

> The institution is expected to have a board-approved ERM framework that guides the risk-taking activities of the organization.

An ERM framework that takes into account the risk profile of the institution needs to be in place. It must be enterprise-wide and tailored to its business activities and operations. The ERM framework should be well-understood throughout the institution and embedded within the culture of the organization. All operational, financial and corporate policies, practices and procedures of the institution must support the ERM framework.

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[7] Credit unions are required by legislation to have an audit committee and a conduct review committee. Where the board fails to appoint an audit committee or conduct review committee, the board shall act in their capacity.

The ERM framework sets basic goals, benchmarks, parameters and limits (e.g., level of losses) as to the amount of risk the institution is willing to accept, taking into account various financial, operational and macroeconomic factors. It also considers the material risks to the institution, as well as the institution's reputation among members, depositors, and other stakeholders. On an ongoing basis, the institution should be satisfied that the ERM framework remains appropriate relative to the risk profile of the institution, its long-term strategic plan, and its operating environment.

The ERM framework is expected to be forward-looking and consistent with the institution's business model, overall philosophy, strategic plan, capital plan, financial plan, business objectives and corresponding risk mitigation strategy. It is intended to provide boundaries on the ongoing operations of the institution with respect to asset class and liability choices, and participation in activities that are not consistent with the stated risk appetite of organization. Refer to Appendix 2 for further details.

## OVERSIGHT OF RISK

To manage risks effectively, an institution's board and senior management need to have a full understanding of the risks inherent to the business model, including each business line and product, and how they relate to its strategy and ERM framework.

### Board Risk Committee

> The board is expected to establish a dedicated risk committee to oversee risk management on an enterprise-wide basis.

In lieu of establishing a separate risk committee, the boards of smaller, less complex institutions must ensure that they have the collective skills, time and information (i.e., appropriate reporting) to provide effective oversight of risk management on an enterprise-wide basis. Many institutions 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 institution's ERM framework, the risk committee is expected to have a sound understanding of the types of risks to which the organization 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. All committee members, including the chair, need to be non-executives of the institution, with an adequate number of committee members having sufficient knowledge in the risk management of financial institutions. Where appropriate, the committee should include individuals with technical knowledge in risk disciplines that are significant to the organization.

As part of its duties to oversee risk management of the institution, the risk committee is expected to seek assurances from the CRO (or equivalent) that the oversight of the risk management activities of the institution are independent from business line management, are 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 institution and exposures relative to risk appetite and approved risk limits. It should

provide input on material changes to the institution'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 occur.

### Chief Risk Officer

The institution is expected to have a senior officer who is responsible for the oversight of all relevant risks across the organization (CRO or equivalent).

The CRO is the head of the institution's risk management function. The CRO and the risk management function are responsible for identifying, measuring, monitoring and reporting on the risks of the institution on an enterprise-wide and disaggregated level.

The CRO needs to have sufficient stature and authority within the organization, and be independent from business line management. The CRO is expected to have unfettered access and, a functional reporting line to the board or the risk committee. The CRO role can be held by another executive (i.e., the executive has dual roles). Some institutions 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. If the CRO is removed from their position for any reason, this should be done with prior approval of the board. The reasons for such removal should be transparent with the Corporation.

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 institution. As well, the CRO's compensation should not be linked to the performance (e.g., revenue generation) of specific business lines of the institution.

While the CRO and the risk management function will influence the institution's risk-taking activities (e.g., to ensure the organization'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 institution. The CRO needs to provide an objective view to the risk committee and the board on whether the institution 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 the business lines 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.

## V. THE ROLE OF THE AUDIT COMMITTEE

The statutory duties, key principles and requirements of the audit committee are outlined in legislation and the Standards. The audit committee is, in particular, responsible for:

- framing policy on internal audit and financial reporting. This includes assessing whether accounting practices are appropriate and within the bounds of acceptable practice.
- approving, or recommending to the board for their approval, the appointment, remuneration and dismissal of the external auditor. The audit committee must assess the skills, resources and independence of the external auditor and be satisfied with the content of the auditor's engagement letter prior to it being signed.
- ensuring that the level of the audit fees is commensurate with the scope of work undertaken
- establishing 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
- providing oversight of and interacting with the institution's internal and external auditors. The audit committee is required to review the performance of both the external and internal auditor, and provide a report to the board on the effectiveness of the auditors on an annual basis. Where part or all of the internal audit function is outsourced, the board still has responsibility to oversee the performance of the internal audit as a whole.
- reviewing and approving the institution's audit plans (internal and external) to ensure that they are appropriate, risk-based and address all the relevant activities over a measurable cycle
- reviewing the annual financial statements and key audit reports
- discussing with senior management and the external auditor the overall results of the audit, the audit report, the quality of the financial statements and any related concerns raised by the external auditor. The audit committee should receive all substantive correspondence between the external auditor and senior management related to its audit findings.
- discussing with the CIA (or equivalent) the effectiveness of the internal control system
- ensuring that senior management is taking necessary corrective actions in a timely manner to address control weaknesses, non-compliance with policies, laws and regulations, and other problems identified by auditors and other control functions
- holding regular in-camera meetings with the external auditor and the CIA (or equivalent) to understand all of the relevant issues and how these issues have been resolved

## VI. DISCLOSURES

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

# VII. SUPERVISION OF CREDIT UNIONS AND SASKCENTRAL

## 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 financial institutions. The board and senior management are designated as key oversight functions in the Corporation's Supervisory Framework.

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

In addition, in situations where an institution is experiencing problems, or where significant corrective action is necessary, the important role of the board is heightened. In these instances, the Corporation requires significant board involvement in seeking solutions and overseeing the implementation of corrective actions.

## THE CORPORATION'S SUPERVISORY ASSESSMENT

The Corporation's supervisory work involves monitoring institutions to assess their condition, the quality of control and governance processes, and compliance with all applicable laws and regulations. Supervision is carried out within a framework that is risk-focused.[8] The Corporation has developed 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 of the institution.

The board and senior management are ultimately accountable for the safety and soundness of the institution, as well as its compliance with governing legislation. As such, the Corporation's reports and findings can provide useful input to the board's own oversight of the institution. 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 that the Corporation follows. Accordingly, the Corporation expects to be promptly notified of any substantive issues affecting the institution.

The board is expected to understand the regulatory environment within which the institution and its subsidiaries operate, as well as 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. The board should also hold discussions with senior management to determine if weaknesses found are broader indicators that similar problems may exist elsewhere in the organization.

The institution's board is expected to consider regulatory findings in its ongoing evaluation of senior management and oversight function performance, recognizing the primary responsibility for identifying weaknesses rests with the board and senior management.

[8] Refer to the Corporation's Supervisory Framework.

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 institution's corporate governance processes. The Corporation will seek evidence that processes exist, are operating effectively, and that the board is able to fulfill its roles and responsibilities.

The Corporation will look to gain insight into the discussions and deliberations at the board and committee level, including those with and without senior management. This may include understanding the board's behaviour and assessing the objectivity, degree of challenge and independence in the decision making process.

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

The Corporation recognizes that an institution makes independent decisions regarding the nomination of board members or appointment of senior management in the course of conducting its day-to-day business.

As part of the ongoing supervisory process, the institution is expected to notify the Corporation of any changes to the composition of the board and senior management, and any circumstances that may adversely affect the suitability of board members and senior management. It is necessary for the process and criteria used in the selection of board and/or senior management, to be transparent to the Corporation.

# 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, as a consequence of operating in a regulated industry, the governance processes of financial institutions are subject to review and may be influenced by the views of the Corporation and other 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 the board and senior management.

# APPENDIX 2 – ENTERPRISE RISK MANAGEMENT FRAMEWORK

As an integral part of the ERM framework, institutions are expected to have a risk appetite statement and risk limits, as well as an outline of the roles and responsibilities of those overseeing implementation of the framework.

## RISK APPETITE STATEMENT

The risk appetite statement reflects the aggregate level and type of risk that the institution is willing to accept in order to achieve its business objectives. Key features of the risk appetite statement include:

- linkage to the institution’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
- qualitative and quantitative measures that can be aggregated and disaggregated
  - qualitative measures may include:
    - significant risks the institution wants to take and why
    - significant risks the institution 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 or liquidity) that the institution is willing to accept
- it should be forward-looking, consider normal and stressed scenarios, and aim to be within institution’s risk capacity, including regulatory constraints

## RISK LIMITS

Risk limits are the allocation of an institution’s risk appetite statement to:

- specific risk categories (e.g., credit, market, liquidity, operational)
- the business line (e.g., retail, commercial, capital markets)
- 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.

## IMPLEMENTATION OF THE ERM FRAMEWORK

Once approved by the board, the ERM framework is to be implemented by senior management throughout the organization. The ERM framework needs to align with the institution’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, etc.) 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.

Effective control, monitoring and reporting systems and procedures must be developed to ensure ongoing operational compliance with the ERM framework, including the following:

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

The board and senior management of the institution should 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 expected to be communicated to the board. The ERM framework must form an integral part of the board's discussions and decision-making processes.