Introduction:
Quality of Risk Management
Assessment Criteria

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INTRODUCTION

Credit Union Deposit Guarantee Corporation's (the Corporation) Supervisory Framework and processes serve as an early identification and warning system designed to protect the interests of all stakeholders. Risk-based supervisory approaches are focused on evaluating an institution's risks and the management of those risks, either through mitigation or increased risk offset, to ensure that there are no undue or excessive exposures that could jeopardize the safety and soundness of a credit union or SaskCentral. This system furnishes the Corporation and provincially regulated institutions with information that supports proactive identification and resolution of issues before they escalate into a costly or unmanageable crisis.

This document introduces and describes the assessment criteria to be used in evaluating the effectiveness of an institution's quality of risk management. It includes corporate governance - Board of Directors and Senior Management – and the control environment - Internal Audit, Financial, Compliance and Risk Management. These are referred to as Oversight Functions.

The Oversight Functions are responsible for providing enterprise-wide oversight of operational or business line management. In carrying out its responsibilities, Senior Management may delegate some of its responsibilities to other Oversight Functions. Not all institutions will have the same level of sophistication within the Oversight Functions and not all credit unions or SaskCentral will choose to resource them internally. The level of sophistication and resourcing will vary, not only based on the nature, scope and complexity of the organization's operations, but also on how the institution chooses to manage its risk exposures and tolerance levels, based on its own business needs and strategic priorities.

The Corporation expects that the nature and extent of oversight by a credit union or SaskCentral over its activities to be commensurate with its complexity and risk profile. In small, less complex organizations, in place of establishing an oversight function, there is an expectation that the board and senior management will ensure that other functions or processes within or external to the institution provide the level of compensating controls and independent enterprise-wide oversight required.

Credit unions and SaskCentral are reminded that risk-based supervisory approaches are designed to accommodate an organization's choices. It is not intended that the institution should restructure or reorganize their processes as a result of these approaches. Credit unions and SaskCentral have the responsibility of identifying, measuring and managing the risks they assume in their organizations. Every risk has cost-benefit implications and the organization will be challenged to choose the course of action that best meets its own strategic needs.

Capital is very important, but cannot be considered a substitute for weak oversight functions or risk management. High levels of capital cannot compensate for material flaws in risk management practices. However, it may be undesirable to fully mitigate risk and it is expected that institutions will hold additional capital, above regulatory minimums, to minimize any future negative impact of the residual or unmitigated risks.

Oversight Functions are related. The work of the Internal Audit, Risk Management and Compliance functions should provide the Financial function with a reasonable level of assurance that financial results can be relied on. As well, the Internal Audit function should play a role in providing an independent assessment of the financial analysis, risk management and compliance programs. As a result, a portion of the internal audit plan should be devoted to assessing the effectiveness of the Financial, Risk Management and Compliance functions and programs.

The following are key points that are helpful to understanding the assessment criteria and how the Corporation applies them, based on a credit union's or SaskCentral's unique circumstances.

1. Assessment criteria should be read in conjunction with the Corporation's Supervisory Framework, Standards of Sound Business Practice (the Standards), directives and guidance or the prudential standards. Credit unions and SaskCentral are expected to comply with all applicable legislation and regulatory requirements. Assessment criteria are designed to objectively assess the degree to which an institution is being managed and operated within prudential legislation and in accordance with regulatory requirements. Assessment criteria are not a replacement, or a substitute, for legislation or regulatory requirements.

2. Assessment criteria represent a high-level overview of "what" the Corporation will be evaluating. It does not provide the details of "how" the Corporation will go about measuring the specifics within significant activities.

3. Assessment criteria and ratings are based primarily on the mitigation of risk. They are deliberately framed to provide a flexible and scalable framework that is able to reflect the unique circumstances of each institution. To support this, they include terms such as "adequacy of," "appropriateness of" and "extent to which." This allows the rating to be scaled taking into account the nature, scope, complexity and risk profile of each organization. Sound judgment is essential in applying criteria to the unique circumstances of each institution.

4. Assessment criteria will vary based not only on the nature, scope and complexity of the organization's operations, but also on how the organization chooses to manage its risk exposures and tolerance levels based on its own business needs and strategic priorities.

5. Assessment criteria presented do not serve as a checklist to which an institution is expected to comply. They serve as an internal tool that guides the Corporation's analytical processes necessary to objectively assess the degree to which a provincially regulated institution is being prudently governed, managed and operated. Ratings assigned are based on actual findings and observations from supervisory activities.

6. Not all assessment criteria will be applicable to all institutions. When an organization believes one does not apply, the Corporation may challenge the organization's reasoning by seeking responses to the following types of questions:
   - Why does the organization believe the criterion is not applicable?
   - What rationale was used to arrive at that conclusion?
   - Was due consideration given to the risks?
   - Through its analysis, did the organization arrive at a more appropriate way to manage the same types of risks?
   - How has the approach worked?

7. Assessment criteria, performance benchmarks and ratings are driven by generally accepted industry practices. The term "generally accepted practices" is not a reference to codified standards, but to practices observed by the Corporation to be in general use within the industry, and which the Corporation considers acceptable, including meeting

all legal and regulatory requirements and expectations. These generally accepted practices are reflected in both general characteristics and performance benchmarks. It is important to note that generally accepted practices often evolve to incorporate new and emerging practices.

8. Assessment criteria that speak to “policies” refer to the guiding principles by which a provincially regulated institution conducts its activities. An institution’s regular or usual practices are derived from these principles, whether written or unwritten.

9. “What is considered necessary” is assessed in relation to a credit union’s or SaskCentral’s risk profile, in the context of its safety and soundness.

10. “In control” refers to an organization that:
    - demonstrates effective corporate governance
    - is operating within an appropriate control environment with effective strategic and risk management processes
    - has demonstrated capability and willingness to proactively identify and suitably resolve significant control weaknesses on a timely basis.

11. “Independence” of an Oversight Function means that the function is not subject to the undue influence of Business Line Management in the areas it oversees, nor is it directly involved in the management or execution of the activities in those areas. To be effective, an Oversight Function needs to be independent of risk taking and revenue generating activities.

12. “Independent reviews” are periodic reviews of Oversight Functions by a person or group independent of the function being reviewed. The need for, and frequency of, these reviews will depend on the size and complexity of the institution and is at the discretion of the institution. Reviews may be carried out internally (e.g., Internal Audit) or by an outside consultant, depending on the objectives of the review and availability of required expertise and resources.