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INTRODUCTION

1. BACKGROUND

In recent years, significant focus has been placed on improving governance and risk management practices in corporations generally, and in Canadian credit unions in particular.

Credit Unions are exposed to a number of risks that can adversely affect their ability to achieve business objectives or could result in a loss of earnings, capital or reputation. A comprehensive, systematic and disciplined risk management approach is critical for the Board and General Manager to pro-actively identify, assess, manage and control the significant strategic, business and process level risks inherent in the credit union's business strategy and operations.

Standards of sound business and financial practices are a set of stated business principles against which credit union boards of directors, general managers and senior managers can measure their performance.

The principles which form the basis of the Standards are not new. The principles are largely practised now by most Canadian credit unions and will not be unfamiliar. These principles serve as a **guide** to assist boards and management:

- **to manage and direct the credit union efficiently and appropriately;**
- **to create an ethical and productive working environment for employees; and**
- **to provide quality service to credit union members.**

The Standards of Sound Business Practices identified in this document are similar to the standards adopted in recent years by credit unions in most provinces, and are modelled after the Standards established in 2001 by Canada Deposit Insurance Corporation (CDIC) for its member institutions.

2. IMPORTANCE OF A CLEAR SET OF STANDARDS FOR THE CREDIT UNION SYSTEM

The quality and soundness of the principles under which a business operates is a major contributor to the business' long-term success. The credit union accepts and manages the funds of people in your community. **To gain and maintain the community's trust, prudent and sound principles must guide the business practices in the credit union.**

Deposit insurance was incorporated as an integral part of the PEI Credit Union System with the legislative amendments to the *Credit Unions Act* in 1991. A critical part of the deposit insurance program involved the establishment of the Credit Union Deposit Insurance Corporation (CUDIC) to oversee and manage the program. **Primary responsibilities of CUDIC set out in the *Credit Unions Act* include the responsibility to:**

a) guarantee the repayment of deposits held with credit unions; and

b) adopt measures designed to alleviate or to minimize the risk and size of claims against a credit union.

The *Credit Unions Act* also makes provision for CUDIC to prescribe standards of sound business and financial practices for credit unions (s. 165) to assist it carrying out its responsibilities.

The adoption of a clear set of generally accepted Standards of Sound Business Practice by the PEI Credit Union System is a critical element of CUDIC's risk assessment process and ensures credit unions are assessed on an objective and equitable basis.

Credit union boards and senior managers are expected to use these Standards to help them "self-assess" whether or not they are conducting the credit union's business in a sound and prudent fashion. Any credit union which determines it is not complying with a Standard has a responsibility to develop and implement an action plan to address the credit union's non-compliance and/or clearly document the reasons for non-compliance.

3. THE DETERMINATION OF STANDARDS ADHERENCE

The ability of a credit union to determine if it is following sound business practices is generally a by-product of governance and management processes already in place to assess whether processes, policies, procedures, controls and internal reporting are appropriate, effective and prudent in their design and application. In this document each Standard (written in **bold** text) is followed by a commentary. The commentary contains explanations of the Standards and examples of the Standards' impact on your credit union.

Throughout this document, there are various "**points to consider**" in the form of questions which will assist credit union boards and senior managers to:

- Understand how the Standards apply to their credit union;
- Evaluate their business practices;
- Judge whether or not their credit union is complying with the Standards; and
- Assess what the credit union can do to comply with the Standards.

If the **majority** of the points cannot be answered with an **unqualified "yes"**, the credit union is likely not complying with the Standard. The points to consider are not intended to be all inclusive but provide **guidance** for credit unions.

Under each Standard a list of resources is provided. These include reference materials, organizations, and personnel that can assist the board and General Manager in determining whether or not the credit union complies with the Standard. These resources can also be of assistance in implementing action plans to ensure the credit union's compliance with the Standard.

4. STANDARDS REPORTING REQUIREMENTS

CUDIC will be developing a reporting format for the use of boards in self-assessing their credit unions and compliance reporting to CUDIC.

Standard 1

Understand and Fulfill Directors' Responsibilities

It is a sound business and financial standard for a Board of Directors to understand its corporate governance responsibilities, meet those responsibilities, and from time to time evaluate its effectiveness in fulfilling those responsibilities.

Commentary

A Board's key responsibilities fall under the following categories:

1. **Strategic Planning**: Developing, approving, and monitoring strategic business plans for the credit union in co-operation with the General Manager.
2. **Risk Identification**: Recognizing, identifying, and evaluating the risks involved in a credit union's business operations.
3. **Communications**: Ensuring that the credit union cultivates a system of effective and courteous communications among its members, Board of Directors, senior management, employees and other key stakeholder groups.
4. **System Integrity**: Ensuring the business operations are functioning properly and effectively, and under a sound system of internal controls.
5. **Competent Management**: Ensuring that the Board hires a qualified General Manager and appropriately oversee his or her activities.
6. **Succession Planning**: Ensuring that the Board has a plan of succession to replace Board members, the General Manager and other key personnel should they resign, retire, or leave for any reason.

To help Credit Union Directors understand their responsibilities, credit unions should implement new Director orientation and advise that mandatory participation in the CUDA (Credit Union Director Achievement) Program is required.

Points to Consider:

- Does the credit union have a current strategic business plan which has been approved by the Board?
- Is the Board satisfied that it is adequately informed about its responsibilities and accountabilities, including under the Credit Unions Act and Bylaws?
- Does the Board ensure that its committees are properly appointed and have clear terms of reference?
- Has the Board established a program for the professional development and training of new Board members?
- Does the Board use a nominating committee to find prospective Board members and to instruct them about their potential responsibilities as a director and, has the Board developed a set of qualifications and a cross-section of skill-sets and experience for Board nominees?
- Does the Board have a procedure to annually assess its own performance?
- Is the Board satisfied that it is informed by the General Manager about significant issues relevant to the Board's responsibilities in an appropriate and timely manner?

- Is the Board satisfied with the processes used for setting agendas and priorities?
- Is the Board satisfied that its meetings are conducted in a manner to ensure issues relevant to the Board's responsibilities are dealt with promptly and effectively, and Directors have adequate opportunities to question and discuss significant issues?
- Does the Board use a documented follow-up procedure to ensure that issues are resolved to its satisfaction?

Resources

CU Bylaw	"Board of Directors"
CU Bylaw	"Nominating Committee"
CU Act	"Directors, Officers and Bylaws"
CUCPEI Corporate Policy	"Eligibility of Directors"
Directors Handbook	"Job Description for Board of Directors"
Directors Handbook	"Roles and Responsibilities"
CUSource - CUDA Module/CUCPEI	"Self Assessment Tools for Board"
CUSource - CUDA Modules	"Board Development and Performance Evaluation"
	"Corporate Governance"
	"Directors Roles and Responsibilities"

Standard 2

Understand Responsibilities of the Board versus the Responsibilities of the General Manager

It is a sound business and financial standard for a Board of Directors to understand that it has the ultimate accountability for the operation of the Credit Union; and, to understand the difference between the responsibilities of the Board and the General Manager.

Commentary

It is the responsibility of the Board to carry out the governance responsibilities - policy development and oversight – whereas, the General Manager is responsible for the daily operations of the credit union.

Responsibilities of the Board

- Ensure that the Board and General Manager develop and implement strategic planning processes;
- Review and approve credit union policies;
- Approve the credit union's business objectives;
- In co-operation with the General Manager, develop and approve strategic business plans;
- Approve annual budgets which support its strategic business plans;
- Represent the interest of members, depositors, and those to whom the Directors owe a fiduciary duty;
- Appoint a qualified and competent General Manager;
- Monitor the performance of the General manager regularly;
- Formally evaluate the performance of the General Manager annually;
- Ensure that the General Manager assesses, reports, and manages risks appropriately;
- Ensure that the General Manager follows the credit union's policies, business plans, and all legislation that applies to the credit union; and
- Oversee member and community relations.

Responsibilities of the General Manager

- Develop and recommend policies for Board consideration and approval;
- Communicate credit union policies and business plans to the appropriate people in the credit union organization;
- Implement policies and plans for business procedures, member relations, and inter-office communications;
- Develop draft strategic business plans for Board consideration and approval;
- Develop budgets to carry out the strategic business plans;
- Regularly report to the Board the progress made on performance targets;
- Regularly report to the Board any exceptions made to policy;
- Hire and train qualified and competent personnel;
- Monitor and evaluate the performance of senior managers regularly;

- Ensure the systems are in place to measure risk levels of the credit union;
- Report risk levels to the Board;
- Ensure that appropriate procedures are in place to manage risks; and
- Ensure adherence to the regulatory regime.

Points to Consider

- Does the Board clearly understand how its responsibilities relate to the responsibilities of the General Manager?
- Does the Board feel comfortable that the level of authority it has assigned to the General Manager is consistent with the accountability it expects from the General Manager?
- Does the Board feel comfortable with how it oversees the activities of the credit union?
- Does the Board periodically discuss whether the balance of responsibilities between the Board and General Manager is appropriate?
- Does the Board ensure that policies are evaluated on a regular basis?
- Does the Board formally evaluate the performance of the General Manager on an annual basis?
- Does the Board evaluate or take steps to ensure that the General Manager assesses, reports, and manages risks appropriately?

Resources

CU Bylaw	"Board of Directors"
CU Bylaw	"Liability and Insurance"
CU Act	"Directors, Officers and Bylaws"
Directors Handbook	"Roles and Responsibilities"
CUSource - CUDA Module/CUCPEI	"Self Assessment Tools for Board"
CUSource - CUDA Modules	"Strategic Planning and the Balanced Scorecard"
	"Board Roles and Responsibilities"
	"Corporate Governance"

Standard 3

Exercise Independent Judgment

It is a sound business and financial standard for a Board of Directors to exercise independent judgment.

Commentary

Directors are accountable and have a fiduciary responsibility to credit union members. A Board of Directors must exercise independent judgment in order to direct and oversee a credit union's business affairs. Effective corporate governance requires a high level of coordination, cooperation, and teamwork between a Board and its General Manager.

A Board and its General Manager must maintain a high level of trust and a good working relationship and make "best efforts" to ensure that the relationship is built on respect. However, the role of the Board is to oversee and sometimes challenge its General Manager. Boards must understand that it is acceptable and sometimes prudent to:

- Deliberate on some matters in the absence of the General Manager/CEO (in camera); and
- Instruct the General Manager to engage consultants to advise the Board in appropriate circumstances, even if there is a risk that the consultant may disagree with the General Manager's point of view.

Points to Consider

- Does the Board periodically consider and discuss the strengths and weaknesses of its working relationship with the General Manager?
- Does the Board feel comfortable enough to employ outside consultants to provide subject matter on areas beyond their expertise?
- Does the Board regularly hold ***in camera*** meetings for discussions in the absence of the General Manager?
- Does the Board feel comfortable about making executive decisions on an informed and independent basis, despite possible disagreement by the General Manager/CEO?
- Does the Board feel comfortable about offering constructive criticism or challenging the advice of the General Manager?

Resources

CU Act	"Directors, Officers and Bylaws"
Directors Handbook	"Roles and Responsibilities"
CUCPEI – Inspection Department	Internal Audit
External Resources	Legal Counsel, External Auditor
CUSource – CUDA Modules	"Corporate Governance"
	"Legal Basics"

Standard 4

Set Limits of Authority for Board Appointed Committees and General Manager

It is a sound business and financial standard for a Board of Directors to determine, in consultation with the General Manager, the policies that will establish the duties, authority and limits, and accountability requirements of Board Committees and the General Manager.

Commentary

A Board of Directors may delegate some of its responsibilities to Board committees or to the General Manager. When the Board delegates' responsibilities to committees or to the General Manager, the Board is still accountable for the results and when assigning such duties, the Board must clearly define the limits of authority for committees and/or the General Manager. The Board must also ensure it receives accurate, timely, and meaningful updates on work it has delegated.

Points to Consider

- Has the Board documented the Terms of Reference for Board committees and the General Manager?
- Are the Board's assignments of responsibilities and authority limits up-to-date?
- Do the mandates (Terms of Reference) of Board committees address the committee's decision-making powers and reporting requirements?
- Do committees report to the Board in a timely manner?
- Is there an established work plan for committees for the upcoming year?
- Are committee mandates reviewed on a regular basis?
- Does the Board review authority granted to the General Manager on an annual basis?

Resources

CUCPEI Corporate Policy	"Committee of the Board"
CU Act	"Directors, Officers and Bylaws"
CU Bylaw	"Nominating Committee"
CUSource – CUDA Module/CUCPEI	"Self Assessment Tools for Board"
Directors Handbook	"Terms of Reference – Committees"
External Resource	External Auditor
CUSource – CUDA Modules	"Art of Chairmanship"
	"Corporate Governance"

Standard 5

Select and Evaluate the General Manager

It is a sound business and financial standard for a Board of Directors to hire a General Manager who has the qualifications and competencies to provide effective and prudent management of the credit union, and to regularly evaluate the General Manager's effectiveness and prudence in managing the operations of the credit union, and in managing the risks to which the credit union is exposed.

Commentary - Selecting the General Manager

A Board should feel comfortable in seeking outside assistance/consultation or contacting Credit Union Central when selecting a person to hold the position of General Manager.

When a Board assesses the qualifications of a General Manager applicant, it must consider the candidate's education, training, experience, and behavioural and technical competency.

When assessing the competence of a prospective General Manager, a Board must consider the candidate's ability and integrity.

The Board should seriously consider seeking advice from independent legal counsel on any contracts the Board is negotiating with its potential (or current) General Manager.

The General Manager ensures that the credit union's policies and business plans, approved by the Board, are implemented in daily business activities.

The actions of the General Manager are accountable to the Board.

The General Manager is responsible to:

- Develop and recommend policies for Board consideration and approval;
- Communicate credit union policies and business plans to the appropriate people in the credit union organization;
- Implement policies and plans for business procedures, member relations, and inter-office communications;
- Participate in the development of a draft strategic business plan for Board consideration and approval;
- Develop budgets to carry out the strategic business plans;
- Regularly report to the Board the progress made on performance targets;
- Regularly report to the Board any exceptions made to policy;
- Hire and train qualified and competent personnel;
- Monitor and evaluate the performance of senior managers regularly;
- Develop a succession plan for senior management and other key employees;

- Ensure that systems are in place to measure risk levels of the credit union;
- Report risk levels to the Board;
- Ensure that appropriate procedures are in place to manage risks; and
- Ensure adherence to the regulatory regime.

Points to Consider

- Is there an up-to-date statement of qualifications and job description for the General Manager?
- Does the Board have the experience and competence to establish selection criteria for the General Manager, or are external resources required?
- Does the Board ensure that its management recruitment team/agency conduct complete background checks to assess a candidate's competence?
- Does the Board have an appropriate contractual arrangement with the General Manager/CEO?
- Does the Board seek independent legal advice on contracts it might be negotiating with the General Manager?

Commentary - Evaluate General Manager Performance

Although a Board of Directors depends on the General Manager to run the credit union's daily activities, the Board remains ultimately responsible for monitoring and assessing the General Manager's performance. A Board must ensure that this performance is consistent with the Board's expectations.

Regular performance evaluations and feedback on those evaluations enhance the General Manager's accountability to the Board. By conducting General Manager evaluations, the Board demonstrates that it is overseeing the General Manager's actions.

Points to consider

- Has the Board developed formal goals and objectives for the General Manager/CEO?
- Has the Board established performance evaluation criteria for the General Manger/CEO?
- Do the criteria address the responsibilities and accountability of the General Manager/CEO?
- Is the Board satisfied that the criteria address the sustainable achievement of the credit union's business objective?
- Is the Board satisfied that the criteria provide the incentives to conduct business operations in a sound and prudent manner?
- Is the Board satisfied that the General Manager's performance evaluation criteria are applied competently and objectively?
- Does the Board understand the responsibility and accountability the General Manager/CEO has assigned to other senior managers?
- Has the Board evaluated the General Managers' performance during the last 12 months?
- Is the Board satisfied that the General Manager conducts a formal performance evaluation on the senior management team on a regular basis?

Resources

CUCPEI Corporate Policy	“CEO Recruitment, Selection, Compensation & Evaluation”
CUCPEI	Human Resource Department
External Resources	Human Resource Consultant, External Auditor, Legal Counsel
CUCPEI – Inspection Department	Internal Audit
CUCPEI – HR Department	Performance Management System
CUSource – CUDA Modules	“Governance and Accountability” “Management Recruitment, Performance Planning & Evaluation”, “Corporate Governance” “Enterprise Risk Management” “Leadership, Succession and Continuity”

Standard 6

Review Compensation and Human Resource Programs

It is a sound business and financial standard for a Board of Directors to ensure that compensation programs and human resource practices are consistent with the credit union's business objectives and comply with the credit union's policies and processes.

> *It is a sound business and financial standard for the General Manager to ensure that an effective, current human resource plan is in place for the recruitment, training, supervision and evaluation of the human resources required for the day to day operation of the Credit Union.*

Commentary (Board of Directors) – Review Compensation Programs

Appropriate compensation programs give the General Manager and the employees incentives to act in the best interests of the credit union. With the proper research and professional assistance, a Board can develop a compensation philosophy that is competitive, fair, and forms a solid base on which to build compensation programs.

Compensation programs include salaries, bonuses, pension contributions, and packages of other benefits such as life, disability, and dental insurance.

A Board needs to satisfy itself that compensation programs help the credit union achieve its business objectives without compromising the viability, solvency, and reputation of the credit union. The Board must take special care (e.g. seek professional advice) to ensure that bonus plans act in the best interests of the credit union, that the costs are accurately estimated and that the bonus plans do not encourage inappropriate risk-taking practices.
Delegation of authority from the Board to its employees is essential for the effective and efficient operation of the Credit Union. The Board needs to clearly identify and understand the implications of any limitations that are to be placed on the authority that is delegated to the General Manager. Also, the Board should be aware that the General Manager may in turn delegate certain authorities to other staff positions. In such cases the Board should be aware of the authority that has been delegated.

Points to Consider
- Has the Board developed a compensation philosophy that defines the programs it will use to attract and retain qualified employees?
- Has the Board approved a compensation policy that can be used to compensate employees?
- If the compensation program includes a performance based component, is the Board satisfied that the process for determining the level of the variable compensation appropriately acknowledges superior performance.
- Does the credit union have a job grading system as a basis for determining compensation levels for their employees?

- Is the Board satisfied that the credit union has appropriate and current human resource policies?
- Is the Board satisfied that the credit union's human resource policies are regularly reviewed?
- Is the Board satisfied that the General Manager gives employees access to training programs, which provide them with an adequate level of skills and knowledge to effectively carry out their responsibilities?
- Is the Board satisfied that the General Manager is effectively supervising the credit union's employees?
- Is the Board satisfied that the General Manager has established proper limits of authority?
- Is the Board satisfied that the employee's responsibility and decision-making authority has been clearly communicated in writing to employees?

Commentary (General Manager) – Manage People Risk

A credit union may be exposed to people risk when:

- Employees do not have adequate skills or knowledge;
- The credit union does not provide training that will enable employees to develop their professional skills;
- Employees are provided with compensation, bonuses, or incentives that are improperly matched to performance goals;
- Human resource policies are not communicated properly to employees or not reviewed periodically;
- The employees do not clearly understand what is expected of their performance or the goals they are asked to achieve; or
- Internal control processes needed to properly regulate, supervise, and separate the duties of employees are ignored or are circumvented.

Human Resource Management: The General Manager must implement an effective human resource management program in order to:

- Identify human resource requirements;
- Attract and retain competent employees;
- Maintain the competency of employees by providing ongoing training and professional development;
- Assign appropriate responsibility and authority to employees;
- Motivate employees to achieve their established goals and performance expectations;
- Assess the performance of the employees against their responsibilities;
- Ensure that employees comply with corporate values;
- Develop an effective succession plan; and
- Ensure that compensation, bonus, or incentive plans do not encourage inappropriate risk-taking behaviour.

Delegation of Authority: The Board and General Manager must clearly define limits of authority in order to expect that:

- The credit union is appropriately and effectively managed at all levels;

- The General Manager delegates authority according to the needs and circumstances of the credit union;
- All of the credit union's managers are accountable for their actions;
- Business decisions are only made by employees who can effectively assess the implications of those decisions;
- Supervisory staff does not assign conflicting duties to employees;
- Employees report to an appropriate level of authority;
- Employees are aware of the authority delegated to them; and
- Employees are aware of the limits of their delegated authority.

Communication of Responsibilities: By documenting employee responsibilities, the General Manager can effectively manage people risk and maintain a position control environment. The General Manager must communicate these responsibilities to employees so that they understand and acknowledge:

- The authorities delegated to them;
- The rules that describe their accountability when exercising authority;
- The methods of evaluating their ability to exercise authority; and
- The corporate values that govern proper business conduct and ethical behaviour.

Supervision: All credit union employees are responsible for performing their assigned duties and maintaining an effective control environment. Employees also need to feel comfortable in reporting significant issues or adverse events to their supervisors or the General Manager.

Segregation of Duties: To effectively segregate the duties of credit union employees, the General Manager must clearly distinguish the responsibilities of those employees who initiate or execute transactions from those who supervise, authorize, or verify the transactions.

By segregating duties among employees and among departments, the General Manager can reduce the risk of errors and manipulation of information. The main reason for segregating employee duties is to prevent a single person from controlling too many stages of certain types of transactions.

Resources

CUCPEI Corporate Policy	"CEO Recruitment, Selection, Compensation & Evaluation"
CUCPEI Corporate Policy	"Code of Conduct"
CUCPEI – HR Department	Performance Management System
CUCPEI	Provincial Job Grading System
External Resource	External Audit
CUCPEI – Inspection Department	Internal Audit
CUSource – CUDA Modules	"Governance and Accountability"
	"Management Recruitment, Performance Planning & Evaluation"
Saskatchewan Central	Hay Group

Standard 7

Set Benchmark for Ethical Business Conduct

It is a sound business and financial standard for a Board of Directors to establish and approve policies of ethical business conduct for Directors, the General Manager, and other employees.

> *It is a sound business and financial standard for the General Manager to ensure that all employees of the Credit Union carry out their responsibilities in a manner which is ethical and consistent with these standards of sound business and financial practices; and, to make the Board of Directors aware of serious breaches of such standards by employees and possible breaches by any member(s) of the Board of Directors.*

Commentary (Board of Directors) - Set Benchmark for Ethical Business Conduct

A strong culture of ethical conduct is vital to the well being of a credit union. Credit unions, as stewards of member assets, must gain and maintain public confidence to remain viable. The reputation of a credit union largely depends on the integrity of its business practices, policies, and people.

Ethical business conduct is a direct result of the ethical behaviour of both Board members and staff in the conduct of the affairs of the Credit Union. Ethical behaviour relates to issues such as the general standard of care exercised by Directors and staff in conducting the business of the Credit Union, compliance with all applicable laws, confidentiality, conflict of interest, abuse of the privileges of office, secret transactions, favoured treatment for family and friends, and other acts that would tarnish the reputation of the Credit Union among the community if such acts were public knowledge.

Points to Consider

- Has the Board considered and approved policies of ethical business conduct for the credit union?
- Do the policies of ethical business conduct address matters that affect the reputation of the credit union (such as conflicts of interest and adherence to governing laws and regulations)?
- Is the Board satisfied that the behaviour of the Directors complies with the policies of ethical business conduct?
- Do the policies include rules governing the hiring of family members of the Board or senior management?
- Do the Board members receive a copy of the policies of ethical business conduct when they are elected to the Board?
- Are Directors required to annually attest to their compliance with the policies?

Commentary (General Manager) - Ensure Business Conduct and Ethical Behaviour

The standards for ethical business conduct, which govern the conduct and behaviour of credit union employees, should be a separate section in the credit union's Human Resources Policies. To maintain an effective control environment, the General Manager must ensure that employees are educated about and comply with these standards.

The Board, General Manager and other senior managers must ensure that their personal conduct and behaviour sets an example for employees.

Points to Consider

- Has the Board considered and approved standards of ethical business conduct for the credit union employees?
- Is the Board aware of any credit union employees with business interest or investments that could be viewed as a conflict?
- Do the policies include rules governing General Manager or senior manager ownership of private business interest?
- Do the policies include rules governing the hiring of family members and friends of the General Manager or other managers employed by the credit union?
- Are employees of the credit union given a copy of the policies of ethical business conduct when they are hired?
- Are the General Manager and other employees required to annually attest to their compliance with the policies?
- Is the Board satisfied that the behaviour of the employees complies with the policies for ethical business conduct?
- Is there an approved process for dealing with non-compliance with the policies?

Resources

CUCPEI Corporate Policy	"Code of Conduct"
CU Act	"Directors, Officers and Bylaws"
Directors Handbook	"Roles and Responsibilities"
CUCPEI	Human Resource Department
CUCPEI – Inspection Department	Internal Audit
External Resources	External Auditor – Management Letter
CUSource – CUDA Modules	"Boards Roles and Responsibilities"
	"Governance and Accountability"
	"Introduction to Corporate Social Responsibility"
	"Directors Roles and Responsibilities"

Standard 8

Conduct Strategic Business Planning

It is a sound business and financial standard for the Board of Directors to approve, in consultation with the General Manager, the business objectives and implementation strategies for each fiscal year, and to regularly assess during the fiscal year the degree to which the implementation strategies are achieving the established business objectives.

> *It is a sound business and financial standard for the General Manager to manage the business objectives and implementation strategies established by the Board of Directors for each fiscal year, and to assist the Board of Directors in regularly assessing the degree to which the implementation strategies are achieving the established business objectives.*

Commentary (Board of Directors) - Conduct Strategic Business Planning

The strategic direction of a credit union is derived from the establishment of its vision and mission, strategic objectives, business objectives, and finally, the action plan.

Business objectives are the short and long-term operating and financial goals of the credit union. They provide the parameters for establishing a strategic plan and for assessing the credit union's programs and the General Manager's performance.

Although the Board expects the General Manager to recommend and draft business objectives, the Board is ultimately responsible for establishing business objectives and ensuring that an appropriate strategic business plan is developed and implemented.

The Board must regularly assess the progress of the strategic plan to ensure that the plan's direction is still appropriate.

The nature and extent of the Board's supervision must be appropriate to the circumstances of the credit union. These circumstances include:

1. The credit union's business environment, including:
   - Competitive developments
   - Changes in economic conditions
   - Legal requirements
   - Regulatory requirements and any recent changes

2. The credit union's business strategy, which takes into account:
   - The nature, size, diversity and complexity of business activities
   - The introduction or termination of major business activities

3. The credit union's financial performance, particularly the amount and sustainability of net income.

4. The outcome of independent evaluations, including:
- Commentary in audit reports
- Loan reviews
- Operational reviews
- Internal control reviews
- Inspection reports

5. The experience and depth of knowledge of the credit union's senior management team.

Points to Consider

- Does the Board have a formal planning process?
- Does the Board understand how it should be involved in the strategic business planning process?
- Does the Board set aside an appropriate time (one or two days) for a planning session each year?
- Is the Board satisfied with its current involvement in the strategic business planning process?
- Does the Board challenge the assumptions used to develop the strategic business plan?
- Do the plan's objectives appropriately balance the desire for sustainable returns and growth with the need for safety and soundness?
- Does the Board have an effective means of determining the credit union members' needs and opinions on products and services?
- Is the Board satisfied that the plan will benefit the credit union and its members?
- Is the Board satisfied with the plan's reasonableness, its feasibility and achievability?
- Is the General Manager measuring the right indicators to determine if the strategic plan is still appropriate?
- Does the Board receive accurate and timely information updates to evaluate the progress of the strategic plan?
- Does the Board receive accurate and timely information to evaluate the financial performance of the credit union?

Commentary (General Manager) - Manage Strategic Business Processes

The General Manager must develop and implement ongoing and effective processes to:

- Stay informed about current business and economic trends;
- Develop business objectives for Board consideration and approval;
- Develop strategies and action plans to meet the business objectives;
- Submit the Strategies and action plans for Board consideration and approval;
- Implement and manage the strategic business plan approved by the Board;
- Review the strategic business plan regularly to ensure it remains appropriate to the credit union's environment, performance, and resources; and
- Provide the Board of Directors with accurate, timely, and meaningful reports on:
    - Implementation of the strategic business plan;
    - Credit union's operating performance; and
    - The credit union's financial performance measured against expected results.

The strategic business plan identifies how a credit union plans to achieve its business objectives. It includes:

- The type of business activity that the credit union will conduct;
- The significant risks to which the credit union will be exposed when conducting the business activity;
- The key functions and resources needed to conduct the business activity;
- The expected short- and long-term operating and financial results/objectives; and
- The development and implementation of annual business plans and budgets.

The strategic business plan is the foundation on which a credit union should build new initiatives. The General Manager must evaluate the credit union's progress toward meeting business objectives by regularly reviewing the credit union's activities and comparing them to the business plan.

Credit unions face continuous changes in their environments, which in turn affect their business plans. These changes reflect:

- Evolving market conditions and consumer product and service needs;
- Competition levels;
- Financial and technological innovation;
- Changes in laws and regulatory requirements; and
- The need to attract and retain talented people - succession planning, staff development programs.

By identifying the significant risks in its strategic business plan, the Board and General Manager can develop processes to mitigate the risks. By knowing the risks, the Board and General Manager can ensure that the plan is appropriate to the credit union's circumstances and financial condition. The strategic plan helps the Board and General Manager to:

- Allocate resources effectively;
- Meet financial targets;
- Review the effectiveness of the credit union's business activities; and
- Set future goals and objectives.

Points to Consider

- ➢ Has the General Manager established criteria to evaluate the credit union's ability to achieve its business objectives?
- ➢ Has the General Manager identified and monitored the internal and external factors that may affect the strategic business plans?
- ➢ Does the General Manager regularly report on the credit union's progress toward the strategic business plans' objectives?
- ➢ Are annual budgets and business plans consistent with and supportive of the strategic plan?

Resources

CUCPEI Corporate Policy	"Strategic Business Planning"
External Resources	Business Consultant/Facilitator
CUCPEI	Human Resource Department
CUCPEI – Inspection Department	Internal Audit
CU Central of Canada	Environmental Scan
CUSource – CUDA Module	"Strategic Planning and the Balanced Scorecard"
	"Strategic Planning"

Standard 9

Oversee Risk Management

It is a sound business and financial standard for a Board of Directors to ensure that it is aware of and regularly evaluates all significant risks to which the Credit Union is exposed, and to ensure, in consultation with the General Manager, that appropriate policies are in place to enable the Credit Union to appropriately manage such risks.

> *It is a sound business and financial standard for a General Manager to assist the Board of Directors in being aware of and regularly evaluating all significant risks to which the Credit Union is exposed, and to implement policies which will enable the Credit Union to appropriately manage such risks.*
>
> *It is a sound business and financial standard for the General Manager to ensure that all staff of the Credit Union adheres to laws and regulations applicable to the fiduciary services.*
>
> *It is a sound business and financial standard for the General Manager to assist the Board of Directors in the development and implementation of policies and procedures consistent with generally accepted financial institution practices, to ensure appropriate documentation of matters and adherence to international financial reporting standards (IFRS) and valuation methods.*

Commentary (Board of Directors) – Oversee Risk Management

A Board must have a high level of understanding of a credit union's exposure to risk if it is to develop a high-quality strategic business plan. By studying the risks facing the credit union, the Board is better equipped to establish a prudent strategic business plan, as well as effective risk management policies, procedures, and controls.

The credit union must proactively identify the significant risks it faces in achieving its business objectives and demonstrate appropriate, effective, and prudent management of these risks. Risk can be considered under three types: risk largely beyond the Credit Union's influence and control (e.g. natural disasters); risk over which the Credit Union has influence but limited control (e.g. reputational risk, unwarranted lawsuits); and risk over which the Credit Union has influence and significant control (e.g. fiduciary risk).

In most cases risk cannot be completely eliminated but it is critical that it be managed so that negative consequences are maintained within acceptable limits.

Points to Consider

- Is the Board satisfied with the manner and frequency by which it is informed of the credit union's significant risks?
- Does the Board establish appropriate and prudent risk management policies on identified risks?
- Does the Board review those policies annually to ensure that they remain appropriate and prudent?
- Does the Board periodically review the Business Continuity Plan?
- Has the Board adopted a policy that sets credit concentration limits for the credit union?

Commentary (General Manager) – Implement Effective Risk Management

The General Manager must develop and implement effective processes to:

- Identify risks inherent in the credit union's current and anticipated operations;
- Develop and submit appropriate and prudent risk management policies for Board approval;
- Review risk management policies regularly to ensure they remain appropriate;
- Establish appropriate and effective procedures and controls to manage the risks within approved policies;
- Monitor the credit union's performance in implementing procedures and controls;
- Provide the Board of Directors with accurate, timely, and meaningful reports about the credit union's significant risks; and
- Regularly develop, review, and update procedures for dealing with unexpected events.

The following paragraphs describe the risk management processes in detail. These processes describe the types of risks to which a credit union can be exposed.

Risk Management Processes: The General Manager is responsible for implementing effective risk management processes. The processes do not protect a credit union from unexpected events, but they enable a General Manager to:

- Identify, assess, and measure the credit union's significant risks;
- Ensure that the significant risks are managed within expectations;
- Allocate risk management resources; and
- Determine whether or not the credit union is "in control".

Risk Identification: Credit unions may be exposed to a number of risks. These include:

- Risks largely beyond the credit union's influence and control (e.g. natural disasters);
- Risks over which the credit union has influence but limited control (e.g. reputational risk, unwarranted lawsuits); and
- Risks over which the credit union has influence and significant control (e.g. fiduciary risk).

Risk Assessment: To ensure that risk management processes are effective, a General Manager must assess the potential impact of identified risks. The General Manager must ensure that risk management processes, assessments, and assessment criteria are appropriate to the type, size, and complexity of the risks.

Risk Policies: Risk policies must specify the limits to which a credit union is willing to assume risk. Some policies are made according to the nature of the risks. For example, a credit union can apply lending limits to help manage credit risk, but it cannot apply specific limits to some technology risks. The Board and General Manager must ensure that the credit union's policies are appropriate to the potential impact of its risks. The General Manager and Board must also regularly review the risk policies when the credit union's circumstances change or are anticipated to change.

Risk Management: To manage risks according to risk policy, the General Manager must:

- Establish processes to manage the credit union's daily risks;
- Assign responsibilities to people who manage the risks; and
- Provide those people with appropriate resources.

By performing these tasks, the General Manager can ensure that:

- Employees accept accountability for the risk management processes;
- Significant risks are managed within expectations; and
- The people managing the risks are supervised effectively.

When the General Manager properly assigns accountability for risk-taking actions, the individuals that make risk management decisions are more likely to:

- Make sure that they understand the significant risks they are taking on behalf of the credit union;
- Assume responsibility for the risk management processes and not pass the responsibility to others.

To ensure employees understand their accountability, a General Manager must:

- Assess how employees carry out risk management activities as part of their performance evaluations; and
- Motivate employees to:
    - Identify risk management weaknesses early;
    - Mitigate those weaknesses; and
    - Disclose risk management breakdowns in a timely manner.

To manage risks effectively, a General Manager must keep the Board informed on:

- The nature and magnitude of risks;
- Anticipated changes in the nature of a credit union's significant risks;
- Information about trends that may affect significant risks, including market developments and emerging economic trends;
- Unexpected risk outcomes;
- The credit union's policies, procedures and controls in place for managing these risks;
- The performance of the credit union's risk management processes; and
- Changes in key risk management personnel.

Planning for Business Disruptions: Credit unions usually prepare for possible business disruptions by subjecting their risk management processes to stress and shock testing. However, some events are difficult to predict. These events include natural disasters, systems failures, negative media coverage, litigation, or events like the terrorist attacks. Even though such events may not be directly targeted at a credit union, they may adversely affect the credit union's business partners or suppliers. This, in turn, can disrupt business at the credit union. By developing business continuity plans for unexpected events, the Board and General Manager can:

- Identify remedial action;
- Minimize the severity of a distress situation; and
- Minimize the disruption associated with the distress situation.

Points to Consider

- ➢ Are all credit union employees aware of the risks related to their responsibilities?
- ➢ Are all Credit union employees aware that they must manage the risks related to their responsibilities?
- ➢ Does the credit union regularly verify the soundness and security of external services providers and their services?
- ➢ Does the General Manager shock test the risk management process to analyse the credit union's significant risks?
- ➢ Are there plans and policies in place to address unexpected events that may affect the credit union's risk management process?
- ➢ Has the General Manager proposed, and the Board considered and approved, a disaster recovery (business continuity) plan for the credit union?

Commentary (General Manager) – Manage Credit Risks

Credit risk is the principal business risk to which credit unions are exposed. When a credit union exposes itself to significant credit risk, it can jeopardize its ability to maintain capital, liquidity, and profitability. A credit union's viability is threatened when its credit quality deteriorates.

Credit Exposure Limits: Diversification of risk is a basic component of sound business practices. The Board and General Manager must diversify the credit union's exposure to credit risks in order to maintain the credit union's safety and soundness. A credit union's credit portfolio contains a high level of exposure to risk when it concentrates its credit accommodations in:

- A single borrower;
- A particular group of associated borrowers (connections);
- An industrial or economic sector; or
- A group of industrial or economic sectors that are interrelated.

Such concentration is considered excessive when potential losses from the credit accommodations are large relative to the credit union's capital or net income.

When significant credit risk exposure is concentrated in one industry, the credit union must diversify its risk. The credit union can do this by providing credit to industries that respond differently to economic cycles, or industries that manufacture different products.

In some circumstances, a credit union cannot avoid excessive credit concentration. For example, a credit union's membership may rely on a single community or particular industry to re-pay credit.

When a credit union realizes that it is exposing itself to such credit concentration, it should not necessarily cease its lending activities in the community. Neither should the credit union take on credit activities it does not fully understand just to diversify its credit risks. There are other options available, including:

- Holding additional capital and liquidity;
- Purchasing or selling credit syndications; and
- Contracting to buy, sell, or trade packages of loans (e.g. within the PEI Credit Union System).

Credit Approval Authority: The Board and General Manager must define levels of credit approval authority and monitor compliance to be reasonably sure that:

- Credit decisions are within established limits;
- Changes to credit terms are made only by authorized individuals;
- Credit problems are recognized in an effective manner; and
- Credit losses are minimized.

The limits of credit approval must reflect the credit-granting philosophy defined by the Board, as well as the size of the credit union and the expertise and experience of the lending staff. Credit approval authorities may be absolute, incremental, or a combination of both. These authorities may also be individual, joint, or shared within a group. The various levels of authority for credit approval differ among credit unions, according to several factors:

- The level of oversight the Board employs to ensure that approved policies are followed;
- The ability of the credit union to absorb risk (capital levels);
- The size, nature, and complexity of credit activities;
- The quality of the credit portfolio;
- The degree of market response required;
- The types of risks being assessed;
- The experience and expertise of those who manage credit risk; and
- The credit union's control environment.

Credit Risk Identification Processes: Credit risk identification processes help a Board and General Manager to identify and control risk. Using credit risk identification processes as a basis, the General Manager can:

- Determine risks in individual credits and in the credit portfolio in a common and consistent manner;
- Determine the balance between risks and rewards and set credit pricing more easily and consistently;
- Allocate capital against credit activities (for example, by setting aside capital for high ratio lending);
- Readily identify situations that warrant special attention; and
- Readily identify situations where an allowance for loss is required.

Credit Risk Evaluation Processes: A credit union's credit risk is greatly affected by the credit worthiness of its borrowers. A borrower's credit worthiness may be affected by factors internal to the borrower, or by external factors. These external factors include:

- The type of business that the borrower practices;
- The borrower's economic sector; and
- The credit worthiness of connected borrowers.

Credit problems often arise when a lender disregards a borrower's credit worthiness, or does not adequately evaluate or rate the borrower's credit worthiness. A General Manager can manage credit risk by ensuring that the credit union's lenders effectively evaluate and assess the credit worthiness of borrowers. By using effective evaluation processes, a lender can:

- Make more effective credit decisions;
- Align credit pricing with risk/return expectations;
- Analyse and control the quality of the credit portfolio;
- Analyse the trends that affect the quality of the credit portfolio; and
- Highlight individual credits or segments of the portfolio that may warrant special attention or warrant the need to recognize actual or likely credit loss.

Managing Credit Exposures that Warrant Special Attention: The Board and General Manager can reduce credit problems by recognizing potentially adverse situations and trends, and promptly correcting them. It may be a sign of adverse credit risk when a lender needs to grant policy exceptions in order to make loans. A credit risk may also arise when the credit quality of single and associated credits, industries, economic sectors, or geographic regions start to deteriorate.

Credit Impairment Recognition: The General Manager must implement an orderly method of recognizing credit problems in order to:

- Effectively appraise credit risk exposure to ensure that all loans will ultimately be repaid;
- Consider all relevant factors in estimating the recoverable amount;
- Identify credit problems and deal with them quickly;
- Value credit problems conservatively, using current market conditions;
- Identify the impact that credit problems will have on income;
- Adherence to CICA Handbook guidelines; and
- A general reserve requirement.

Points to Consider

- ➢ Have the Board and General Manager provided sufficient resources (budget, information, training, processes, and technology) for employees to execute and manage the credit risk for the credit union?
- ➢ Are the employees competent in their ability to manage credit risk?
- ➢ Does the General Manager track and report credit concentration statistics?
- ➢ Can the credit union Board and General Manager demonstrate the prudence of the credit union's loan policies?
- ➢ Does the General Manager ensure that loans are consistently assessed for risk?
- ➢ Do the management information systems (systems designed and used by managers to obtain the information they need to manage effectively) enable timely adjustments to be made to the credit risk strategy?

Commentary (General Manager) – Manage Fiduciary Risk

Business activities that carry fiduciary risk can include:

- Investment planning and other advisory services;
- Agency activities;
- Mutual or investment funds management;
- Custodial arrangements; and
- All networking arrangements.

Fiduciary risk increases as a credit union's services become more diversified and complex. Such services include brokering and wealth management. The Board and General Manager must carefully consider and manage the credit union's exposure to fiduciary risk to maintain its safety and soundness.

Fiduciary risks are minimal when credit unions act only as intermediaries - simply taking deposits and providing loans. Once a credit union advertises its wealth counselling services and charges fees for providing advice, the fiduciary risks greatly increase. Members have a right to expect that they are receiving sound advice on managing their portfolios and can sue if they don't receive it. If they are to effectively manage fiduciary risk, a Board and General Manager must understand the difference between risks of an intermediary relationship and the risks of a client/advisor relationship.

Fiduciary activities affect the reputation of a credit union, and are also subject to risks that are difficult to measure and quantify, such as legal risks. These fiduciary activities may have a significant impact on a credit union's capital and earnings.

Financial institutions have always had a responsibility to protect the privacy of their customers. New regulations in the *Personal Information, Protection and Electronic Documents Act* embed those responsibilities in legislation. A credit union can face substantial financial penalties if the credit union's records are inappropriately used or somehow made available to an unauthorized third party.

Points to Consider

- ➢ Are there adequate procedures and controls in place to ensure that a credit union is complying with application laws and regulatory requirements?
- ➢ Has the credit union trained employees on their responsibilities under the law?
- ➢ Do employees have the capability to fulfil those responsibilities?
- ➢ Do the systems that management has developed to obtain and track information enable the General Manager to make timely adjustments to the fiduciary risk strategy?
- ➢ Is there a compliance regime in place for wealth management, privacy and money laundering?

Commentary (General Manager) – Manage Procedural Risk

Documentation of Policies, Procedures, and Processes: By documenting significant business activity and risk management processes, the General Manager can ensure that appropriate controls are in place to reduce the occurrence of undetected errors or misconduct. Proper documentation helps the General Manager to:

- Identify the aspects of significant business activities and risk management processes that are vulnerable to undetected errors or misconduct;
- Evaluate the probable and potential effect that errors or misconduct will have on the credit union if the problems are not quickly detected;
- Ensure that sufficient controls are in place to protect the business activities, assets, and key information of the credit union and its members; and
- Guide and oversee employees in performing their duties.

Integrity of Financial and Other Information: When decision-makers rely on inaccurate or incomplete information (such as accounting information), they are more likely to make poor business decisions. When this occurs, the credit union is subject to risk. To maintain the integrity of accounting information, business records, and valuation practices, the General Manager must ensure that:

- Accounting practices are appropriate to the credit union's circumstances and size;
- Effective controls are implemented over accounting and record-keeping procedures;
- Effective controls are implemented over member account information;
- The quality, quantity, and value of assets and liabilities are regularly monitored and reviewed;
- Assets and liabilities are properly valued and accounted for; and
- Decision-makers receive complete, accurate, and timely business information.

Management Information Systems: A General Manager must employ a current, accurate, and meaningful management information system in order to make informed decisions and effectively communication information about the credit unions operations and significant risks to decision-makers. These decision-makers can then review the information and act accordingly.
The nature of the business risks will determine:

- How often information related to the business risks is gathered;
- The level of detail needed in the information;
- The amount of written analysis and explanation accompanying the information; and
- The medium by which the information is communicated.

The General Manager must review the credit union's information gathering systems regularly to assess:

- The currency and relevancy of information;
- The adequacy of the systems' performance; and
- The quality of the systems' performance over time.

Points to Consider

- Is the Board/General Manager satisfied that sufficient preventive controls and detection methods are in place to protect the financial information and other important information related to the credit union and its members?
- Is the Board/General Manager satisfied that the credit union has effective and accessible documentation that can help employees meet their responsibilities?
- Is the Board/General Manager satisfied that the system of accounting for the credit union's assets and liabilities is effective?
- Is the Board/General Manager satisfied that the credit union's assets and liabilities are properly valued?
- Is the Board/General Manager satisfied that the management information systems allow all decision makers access to current, accurate, and meaningful information?

Commentary (General Manager) – Manage Outsourcing Risk

Credit unions increasingly rely on external contractors to perform services they would otherwise provide themselves. Hiring external services, or outsourcing, can expose a credit union to more operational risks than when the services are conducted internally. Such operational risks include:

- Loss of control over the services;
- Overpayment for the services;
- Interruption of service due to financial or other difficulties experienced by the external contractors; and
- Inappropriate quality or security which may affect the credit union's reputation.

Points to Consider

- Does the credit union have adequate procedures and controls to ensure high quality and reliable service from external contractors?
- Are the Board and General Manager satisfied that the credit union's outsourcing activities do not subject the credit union to contingent liability?
- Are the Board and General Manager satisfied that disruptions to the external contractor's business will not likewise cause business disruptions at the credit union?
- If so, are the Board and General Manager satisfied that the external contractor also has a business continuity plan?

If the credit union uses an in-house banking system, does the Board engage external IT specialist or auditors to perform independent security and procedure audits (5900 or comparable audit) at least annually?

If the credit union uses an in-house banking system, does it ensure that Credit Union Central (or the appropriate licensing authority) tests and approves changes to the banking system and the local switch before implementing the changes?

Commentary (General Manager) – Manage Technology Risk

Credit unions depend on information technology (IT) to operate their business. IT needs include computer hardware, computer software, digital data files, and IT professionals. Information Technology investments expose credit unions to significant risk because interruptions and failures in technologies, or the improper use and control of technologies, can greatly disrupt business activities. These disruptions can cause a loss in business and member confidence. The General Manager must implement effective processes for developing technology to ensure that:

- The credit union has a current technology strategy;
- The use of the credit union's technology complies with the strategic business plans and meets business activity needs; and
- Technologies are authorized, tested, and documented before they are implemented.

The General Manager must also implement effective processes for technology security to ensure that:

- Appropriate and effective firewalls and security systems exist;
- Security audits are routinely and effectively performed;
- Its information technology facilities (such as computer hardware, computer software, and digital data files) are reliable: and
- Access to technologies (including recorded, processed, reported, and stored information) is restricted to authorized people.

By implementing data backup procedures, data recovery procedures, and standby arrangements, a credit union can continue its business activities in the event of a technology disruption. Given the adverse impact of a technology interruption or failure, the General Manager must periodically review and stress-test the standby arrangements.

League Data is a supplier of such services as Interact, Master Card transactions as well as electronic switch and clearing systems. For those credit unions using their services, League Data must meet all security requirements including the 5900 audit annually.

The credit union must carefully control and monitor access to its in-house banking system. To maintain security it must log and audit all access by external parties such as software and hardware suppliers.

The Board and General Manager of the credit union must ensure that the banking system meets the standards required to link to all networks being utilized. The banking system must also meet the performance and reporting requirements of all connectors.

Boards and General Manager must therefore ensure that their in-house banking systems are subjected to external security audits from time to time and that they meet all reporting requirements and performance standards established by licensing authorities.

Points to Consider

- Are the Board and General Manager satisfied that the credit union's technology is appropriate for the needs of the credit union and is cost-effective?
- Are the Board and General Manager satisfied that the credit union's information technology professionals have the expertise and the resources to safely manage the computer systems?
- Has the credit union's banking system undergone an external security audit or attestation to ensure that member data is protected from unauthorized access?
- If the credit union uses an in-house banking system, does it ensure that Central (or the appropriate licensing agency) tests and approves changes to the banking system and the local switch before implementing changes?

Resources

CUCPEI – Inspection Department	Internal Audit, Loan Risk Rating
CUCPEI	Loan Policies
CUCPEI Corporate Policy	"Code of Conduct"
External Resources	Independent IT Consultants
	League Data
	External Auditor, Management Letter
	Legal Counsel
	Business Consultants
CUSource – CUDA Module	"Enterprise Risk Management"
	"Financial Red Flags"
	"Monitoring Credit Union Performance"
	"Board Roles and Responsibilities"
	"Corporate Governance"
	"Legal Basics"
CU Act	"Directors, Officers and Bylaws"
	"Examination and Inspection"
	"Financial Disclosure and Audit Financial Statements"
CU Bylaw	"Liability and Insurance"
CU	Loan Policies, Allowance for Impaired Accounts Reports

Standard 10

Oversee Capital (Equity); Liquidity and Funding; and Asset/Liability Management

It is a sound business and financial standard for a Board of Directors to establish and monitor the capital (equity) requirements of the Credit Union, and to ensure, in consultation with the General Manager, appropriate policies are in place to manage the established requirements.

It is a sound business and financial standard for a Board of Directors to establish and monitor the liquidity and funding requirements of the Credit Union, and to ensure, in consultation with the General Manager, appropriate policies are in place to manage the established requirements.

> *It is a sound business and financial standard for the General Manager to assist the Board of Directors develop and evaluate policy related to the capital (equity), liquidity and funding, and asset/liability requirements of the Credit Union, and to implement practices which are consistent with the established policy.*

Commentary (Board of Directors) – Oversee Capital (Equity) Management

Capital is a necessary financial resource that supports credit union operations and acts as a safety net against unanticipated losses. It is also a measurement of the credit union's financial performance and the credit union's safety and soundness. A strong capital position builds public confidence and allows a credit union to be flexible in choosing business opportunities.

In order to set appropriate capital policies, the Board must understand the credit union's capital needs and obtain evidence that the General Manager is managing the credit union's capital effectively.

Points to Consider

- Does the Board understand that lack of sufficient capital may significantly affect the credit union's opportunities for new business?
- Does the Board understand regulatory capital (equity) requirements represent the minimum level of capital?
- Has the Board set appropriate and prudent capital management policies for the credit union, including policies on the quality and quantity of capital needed to support the credit union's current and planned operations?
- Has the Board established a policy for the accumulation of capital beyond regulatory minimums so that the credit union can pursue business opportunities while maintaining an adequate margin of safety?
- Does the Board review capital management policies at least annually to ensure they remain appropriate and prudent?
- Is the capital at a level to provide a necessary financial resource to support operations and provide a sufficient safety net against unanticipated losses?
- Does the Board have a policy governing the maximum level of fixed assets of the credit union?

Commentary (Board of Directors) – Oversee Liquidity and Funding Management

Liquidity is the availability of funds to honour all commitments as they arise. Virtually every financial transaction has implications on the credit union's liquidity. Since liquidity is critical to and determines the day-to-day viability of the credit union, effective liquidity and funding management is a fundamental component of safe and sound management.

Points to Consider

- Is the Board aware of the regulatory and mandatory requirements for liquidity (10% of credit union assets)?
- Does the Board clearly understand the risks that arise from not having adequate liquidity?
- Does the Board have a current liquidity policy?
- Is the Board satisfied that the processes used to identify, measure, and manage liquidity and funding requirements address all relevant internal and external factors?
- Is the Board satisfied that information it receives about the liquidity and funding profile is timely, relevant, accurate, and complete?

Commentary (General Manager) – Manage Asset/Liability Risks

The two main risks which arise are asset/liability mismatches and foreign exchange exposure. An evaluation of the maturities and re-pricing dates of assets and liabilities may reveal structure risks. The risks exist when assets and liabilities are mismatched by re-pricing date, final maturity, currency pricing, and cash flow (liquidity).

The credit union has a mismatch risk when the re-pricing dates of its assets do not match the re-pricing dates of its liabilities. Cash flows can be significantly influenced if a change in interest rates affects only one side of balance sheet. The amount at risk depends on:

- The extent of interest rate changes;
- The direction of interest rate changes;
- The degree to which the credit union is mismatched; and
- The amount of time that the mismatch will exist.

When foreign exchange rates change, a credit union can also be exposed to foreign exchange risks. The credit union has a foreign exchange mismatch risk whenever it holds foreign currency that is not locked into a fixed exchange rate against the Canadian dollar. The amount at risk depends on:

- The extent of potential exchange rate fluctuations;
- The amount of money held in the foreign currency; and
- The amount of time that the credit union must hold the foreign currency.

The General Manager must manage the asset/liability risk so that changes in interest and exchange rates do not adversely affect the credit union's profitability, capital, and liquidity.
The details of asset/liability risk management differ among credit unions, according to several factors:

- The nature, size, and complexity of the credit union's asset and liability structure;
- The frequency, volatility, and direction of changes in the components that underlie its asset/liability structure;
- The nature, size, and complexity of the credit union's other risks and overall risk profile;
- The credit union's ability to absorb potential losses through earnings;
- The credit union's capital, liquidity, and funding requirements; and

- The credit union's ability to respond quickly to changes in any of the components of its assets and liabilities so that earning, capital, and liquidity are not adversely affected.

Asset/Liability Risk Management Policies: The General Manager must establish levels of tolerance to asset/liability risk exposures in order to:

- Manage the asset/liability risks within the credit union's risk exposure limits;
- Ensure that asset/liability risks do not adversely affect a credit union's profitability, capital, and liquidity; and
- Ensure that the risks do not prevent the credit union from achieving its business objectives.

As with other aspects of risk management, a trade-off exists between risk and return. Due to business or economic reasons, a credit union may not want, or may not be able to fully match its assets and liabilities. The objective of asset/liability risk management is not to **eliminate** exposure to asset/liability risk, but to **manage** the impact of changes in the components that underlie a credit union's assets and liabilities.

Point to Consider

- ➢ Have the Board and General Manager provided adequate resources (such as money, information, training, processes, and technology) for employees to execute the asset/liability risk strategy and manage the risk?
- ➢ Are employees competent in their ability to manage the asset/liability risk for the credit union?
- ➢ Does the asset/liability risk strategy consider past, current, and future risk issues?
- ➢ Have the Board and General Manager developed and implemented foreign exchange risk policies?
- ➢ Do the systems that management has developed to obtain and track information enable the General Manager to make timely adjustments to the mismatch risk strategy?
- ➢ Have the Board and General Manager developed and implemented asset/liability matching policy?

Commentary (General Manager) – Manage Capital (Equity)

Policy Considerations: A credit union must ensure that its capital meets legislated requirements and that the capital can support its current and planned operations.

Capital is a necessary financial resource that supports credit union operations and acts as a safety net against unanticipated losses. Capital is an important factor considered by regulators, market analysts and others when assessing the safety and soundness of a credit union. A strong capital position builds confidence.

The General Manager must develop and implement processes to ensure that the credit union's capital is sufficient to balance overall risks. Such processes must account for the different levels of complexity in the credit union's business activities, and the different risks related to these activities.

Capital requirements differ among credit unions. When a Board and General Manager assess the credit union's capital needs, they must consider several factors, including:

- Changes in the credit union's business strategy (anticipated acquisitions or divestitures as well as growth or decline in the credit union's assets and liabilities);
- The nature and size of the risks to which the credit union is potentially exposed;

- The credit union's credit risk concentrations;
- The credit union's risk management policies and processes;
- The amount of capital tied up in fixed assets; and
- The capital's ability to absorb losses.

When the Board and General Manager assess the ability of the credit union's capital to absorb losses, they must consider several factors. These factors include:

- The credit union's earnings;
- The credit union's ability to retain its earnings;
- The credit union's allowance for loan losses;
- The credit union's capital position relative to regulatory and risk-related capital requirements; and
- The credit union's ability to raise additional capital in a timely and cost-effective manner.

Process Considerations: The Board and General Manager must assess capital whenever the credit union's risk profile changes. Such changes typically occur when;

- The credit union introduces new business lines or products;
- The credit union experiences increased business volumes;
- The concentration or quality of the credit union's assets changes; or
- The business or economic environment changes.

When assessing the adequacy of its capital, a credit union must look beyond its current capital position. The conditions on which a capital assessment is based will change over time. Therefore, the General Manager must develop processes for assessing and fulfilling the credit union's anticipated capital needs.

When projecting the credit union's capital requirements and position, the Board and General Manager must consider:

- The credit union's current capital requirements and position;
- How foreseeable changes in legal or regulatory requirements affect capital;
- How foreseeable changes in the credit union's business activities, risk profile, assets, and liabilities affect capital; and
- How much capital a credit union will require in order to pay patronage refunds, dividends, or other distributions.

An important element of strategic management is the allocation of resources (such as capital) to support a business strategy. Accordingly, a credit union must coordinate its capital management processes with its strategic and risk management processes.

Points to Consider

- ➢ Is the Board satisfied that the capital management process optimizes the credit union's use of capital, given its risk profile?
- ➢ Are capital levels monitored and reviewed monthly?
- ➢ Are capital management processes systematic and comprehensive?
- ➢ Does the credit union regularly review the projections of its capital requirements to ensure that they remain valid?

Commentary (General Manager) – Manage Liquidity and Funding

Policy Considerations: Every financial transaction at a credit union has an impact on its liquidity. Liquidity determines the credit union's ability to function from day-to-day. Effective liquidity and funding management is a basic component of sound business practice. Credit union's operational liquidity must meet anticipated day-to-day cash commitments and regulatory liquidity requirements.

Usually sources of liquidity include deposits, loan payments, asset sales, and borrowed funds. In managing its liquidity, a credit union must consider whether the nature and terms of the liquidity funds correspond with the credit union's specific liquidity requirements. The credit union must also consider the reliability of the sources. The liquidity needs of a credit union are based on several factors, including:

- The extent to which cash flows from maturing assets match the cash flows from maturing liabilities:
- The credit union's ability to access its investments;
- The diversity and stability of the credit union's funding sources;
- The credit union's anticipated ability to renew or replace deposits
- The credit union's capacity and ability to borrow; and
- Extraordinary market conditions or events.

Operating liquidity is generally considered adequate if the credit union's expected cash inflows, supported by an ability to borrow, match expected cash outflows. However, these cash flows are not completely predictable because they are subject to circumstances beyond a credit union's control. These circumstances include credit defaults, member draw downs on credit commitments, deposit redemptions, and loan pre-payments.

Deposits are the primary source of funding for credit unions. Other liabilities may be a limited source of funding according to origination and term structure. **A concentration in a funding source increases a credit union's exposure to potential liquidity problems and may also restrict its ability to manage cash flow**.

The primary liquidity risks are unplanned deposit withdrawals and decreases in deposit renewals. Deposits may decline because depositors may:

- Lose confidence in the credit union;
- Experience a decline in available savings; and
- Find more attractive, competitive investments elsewhere.

Points to Consider

- ➢ Is the Board aware of its liquidity management options?
- ➢ If the credit union relies on brokered or wholesale deposits, does it manage the associated risks?
- ➢ Does the General Manager regularly review the projections of the credit union's liquidity needs to ensure that they remain valid?

Resources

CU Bylaw	“Finance”
CU Act	“Financial Disclosure and Audit Financial Statements”
External Resource	External Audit
CU	Asset/Liability Management Policies
CUCPEI – Inspection Department	Internal Audit
CUSource – CUDA Modules	“Enterprise Risk Management”
	“Financial Red Flags”
	“Monitoring Credit Union Performance”
	“Asset-Liability Management”
CUCPEI Corporate Policy	“Budgets”
CUDIC	Bylaw on Equity Requirement

Standard 11

Set the Benchmark for the Control Environment

It is a sound business and financial standard for a Board of Directors to ensure, in consultation with the General Manager, that effective systems for internal controls are in place.

> *It is a sound business and financial standard for the General Manager to implement internal controls which are consistent with any policy established by the Board of Directors and generally accepted financial procedures.*

Commentary (Board of Directors) – Set the Benchmark for the Control Environment

The control environment of a Credit Union strongly influences the effectiveness of risk management processes. It also impacts the attitudes of employees with respect to complying with internal controls. The control environment of the Credit Union is shaped by:

- The Board's governance approach;
- The General Manager's management style and example;
- The Credit Union's organizational structure;
- The resources allocated to effective control systems;
- The extent of training received by employees; and
- Adherence to established policies and procedures.

It is the responsibility of the Board to ensure that appropriate oversight is provided for the policies and procedures adopted to ensure appropriate internal controls. The primary responsibility for such oversight on a day to day basis rests with the General Manager. The Board can receive assistance in meeting its responsibilities with respect to oversight of internal controls through:

- The Audit Committee established by the Board to provide oversight for audit and other financial matters;
- The internal auditing activities which are normally carried out by staff working independent of one another and reporting to the General Manager, however, from time to time it is beneficial to have the internal auditing activities reviewed by an external resource;
- The inspection reports conducted from time to time by the Inspector of Credit Unions employed by the Credit Union Deposit Insurance Corporation; and
- The external audit report conducted by a public accountant external to the Credit Union system.

Points to Consider

- Is the Board satisfied that its governance approach, control philosophy and the organizational structure facilitates coordinated management support and an appropriate control environment?
- Is the Board satisfied that the credit union has sufficient resources (such as people, information, technology, and equipment) to properly control its operation and risks?
- Is the Board satisfied with the nature and extent of the delegation of responsibilities?

- Does the Board carefully consider the control weaknesses identified by regulators and external auditors?
- Does the Board ensure that the General Manager corrects those control weaknesses?
- Is the Board satisfied that information it receives about weaknesses or breakdowns in controls is timely, relevant, accurate, and complete?

Commentary (Board of Directors) – Ensure Control Systems

The General Manager has the credit union "under control" when he or she can give evidence to the Board that:

- The credit union's business operations are complying with the Board's direction;
- The strategic, risk, capital, liquidity, and funding processes are being managed effectively; and
- An appropriate control environment supports credit union operations.

The Board must ensure that appropriate oversight is being provided on critical matters such as financial controls, management practices, information systems integrity and management's compliance with the corporate code of conduct.

The Board is normally assisted in carrying out its "oversight" responsibility by the work of and/or information provided through:

a) the audit committee;
b) internal audit functions;
c) the Inspector of Credit Unions; and/or
d) the annual audit carried out by the external auditor (including the management letter provided by the auditor).

For the purpose of clarifying the above noted entities/functions the following brief explanation is provided:

- **The Audit Committee** is a committee appointed by the Board of Directors with a mandate to provide oversight and deal with audit and financial matters.

- **The internal audit function** is normally carried out by an employee(s) of the organization who works independently of the accounting and other departments concerned with financial and operational activities of the organization. The work involves ongoing review of internal controls, processes and books of accounts. The reporting relationship is normally to the General Manager. In order to avoid duplication of effort, the internal audit work should be coordinated with the work of the external auditor. While the internal audit function is a critical part of this Standard, the credit union, depending on its size and work load, may consider having the internal audit work carried out through a shared resource with other credit unions, the Credit Union Central or through an outsourced contract with an accounting firm and/or rely on the inspection reports by the Inspector of Credit Unions**.**

- **The Inspector of Credit Unions** is a person(s) designated under the *Credit Unions Act* with authority to cause the inspection of a credit union. For the purpose of clarity, an inspection means the examination of the affairs and financial condition of a credit union as required by the *Credit Unions Act*. The Inspector reports his/her findings to the Board of the credit union, Credit Union Central and CUDIC. Inspections are normally conducted annually but follow-up inspections may be conducted, where significant issues are identified, at the direction of CUDIC and/or Central or at the request of the credit union.

- **The External Auditor** is a public accountant as defined under the *Public Accounting and Auditing Act* (CA). The external auditor is independent from the organization and is engaged to perform an independent audit function on an annual basis and provides reasonable assurance that published audited financial statements are free from material mis-statement and are in accordance with legislation and relevant accounting standards. As part of the audit, the auditor also assesses overall internal controls which includes a review of information technology control procedures.

In addition to certifying the audited financial statements, the auditor normally provides a "management letter" to the Board of Directors (through the Audit Committee if one exists) and the General Manager identifying any management and system control issues he/she feels are notable.

Points to Consider

- Has the Board obtained evidence from external sources that the internal controls are adequate and competently managed?
- Does the Board carefully consider the control weaknesses identified by the Inspector, and/or external auditors?
- Does the Board ensure that the General Manager takes appropriate action to correct those control weaknesses?
- Is the General Manager's assessment of whether the credit union is "in control" consistent with the observations of external audits and reviews?
- Is the Board satisfied that the reports it receives about internal controls are complete, timely, and objective?

Commentary (General Manager) – Manage Control Environment

Credit unions embed internal controls in their business activities to manage risk and to assign responsibility to the people managing the risks. Credit unions also use internal audit functions to verify that the credit union's controls are effective.

The General Manager must regularly review the credit union's control systems to ensure that the systems are appropriate to its business activities and that all elements are functioning well.

Process to Ensure Control: A Board of Directors and General Manager can obtain evidence that they are "in control" from several sources:

The audit committee (or in absence of an audit committee, the Board): The audit committee meets with the credit union's external auditors. It may also receive reports from the internal control staff or other employees who perform internal audit duties;

The internal control function: The purpose of the internal control function is to provide an ongoing evaluation on the extent and effectiveness of the control systems.

The Inspector of Credit Unions: The *Credit Unions Act* requires that each credit union be examined and inspected annually by the Inspector. The findings of the Inspector are reported to the credit union, Credit Union Central and CUDIC

External sources: These sources can provide an independent view of the effectiveness of the credit union's internal control systems and control environment.

Credit union branch managers and department managers: Managers can assess whether the significant risks in their areas of responsibility are being effectively managed.

Front-line responsibility for control rests with those who directly manage the credit union's business activities. These managers are in the position to provide evidence to the General Manager that their control processes are effective. The timing and extent of work involved in obtaining this evidence differ among credit unions, according to several factors:

- The nature of the business activity;
- The significant risks associated with the activity;
- Whether the business activity is new or on-going;
- How the activity is delivered;
- The nature of frequency of changes in the business activity;
- The nature and stability of controls applied to the activity;
- Experience of personnel involved in the activity; and
- The strength of management involved in the business activity.

Audits are the best way to verify whether or not a credit union's internal control systems are appropriate and effective. External parties that are independent from the credit union, as well as its external auditors, may carry out internal control audits. To be effective, those who perform internal audits must:

- Independently report to the Board of Directors, the audit committee or the General Manager;
- Have an appropriate mandate (objectives, responsibilities, and accountability);
- Be unrelated to the business activities they are auditing;
- Have sufficient financial and other resources (including qualified and competent people); and
- Consistently apply an audit approach that focuses on risk.

The details of a control environment differ among credit unions. To maintain an effective control environment, the General Manager must:

- Ensure an appropriate and effective organizational structure;
- Hire qualified and competent personnel who perform their duties effectively;
- Clearly communicate to relevant individuals their responsibilities for managing and controlling significant business activities;
- Ensure that employees can report any significant deficiencies in the control environment in an open and timely manner; and
- Implement sufficient, secure, and effective management information systems.

Points to Consider

- Do the management styles and behaviour of the General Manager and other senior managers encourage open communication about control issues with the credit union?
- Do employee performance expectations include the compliance with the credit union's internal control systems?
- Does the credit union have a training program that helps employees understand, respect, and implement internal control processes?
- How and to what extent do the Board and General Manager consider observations from the Inspector and/or external sources about the management of the credit union's operations and risks?
- Does the General Manager provide timely and meaningful reports to the Board about actions that the credit union has taken, or is planning to take, to address these issues?

Resources

CU Act	"Examination and Inspection"
CU Bylaw	"Finance"
CU Act	"Financial Disclosure and Audit Financial Statements"
CU Bylaw	"Financial Disclosure an Audited Financial Statements"
External Resource	External Audit
CUCPEI – Inspection Department	Internal Audit – Inspection Report
	"Corporate Governance"
CU	Monitoring of Balanced Scorecard
CUSource – CUDA Modules	"Corporate Governance", "Enterprise Risk Management", and "Governance and Accountability"