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Standards of Sound Business and Financial Practices

For Nova Scotia Credit Unions

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What are the Standards of Sound Business Practice?

The Standards of Sound Business Practice (the Standards) are a set of stated business principles against which credit union boards of directors, General Manager/Chief Executive Officers (CEOs), and senior managers can measure their performance. You can determine if you are meeting your management duties in a **sound and prudent** manner by comparing your performance with the Standards. Standards 1 – 14 relate to the duties and responsibilities of the board of directors and standards 15 – 27 relate to the duties and responsibilities of the General Manager/CEO.

The principles in the Standards are not new. They are largely practised now by most credit unions and will not be unfamiliar. These principles serve as a guide to help you:

- Manage and direct your credit union efficiently and appropriately;
- Create an ethical and productive working environment for employees; and
- Provide quality service to credit union members.

Why do you need to know the Standards?

The quality and soundness of the principles under which a business operates is a major contributor to the business's long-term success. The credit union accepts and manages the funds of people in your community. To gain the community's trust, prudent and sound principles must guide the practices in your credit union. As guarantor for the deposits of Nova Scotia's credit unions, the Nova Scotia Credit Union Deposit Insurance Corporation (CUDIC) must ensure that all credit union directors and General Managers/CEOs have standards against which to measure their performance. Section 157 of the Credit Union Act provides the following power to CUDIC:

> *j). "in consultation with the Superintendent and the Central, issue directives in relation to sound business and financial practices and procedures to be followed by credit unions……."*

CUDIC expects credit union boards and senior managers to refer to the Standards to help them recognize whether or not they are conducting the credit union's business in a sound and prudent fashion. This process is called "self-identification". If you recognize that your credit union is not complying with a Standard, you have a **responsibility to develop and implement an action plan to address your credit union's non-compliance, or clearly document the reasons for non-compliance.**

CUDIC has a responsibility to the depositors in the credit union system and to the system itself to ensure that credit unions comply with the Standards and avoid inappropriate risks.

You should apply the Standards to your credit union so that you can provide pro-active, forward-looking direction and management to your credit union.

How do you know if you are complying with the Standards?

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 the document, you will encounter **"Points to Consider"**. These are questions that will help you:

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

If you cannot answer the **majority** of the points with an **unqualified "yes"**, you are not complying with the Standard. The *points to consider* are not all inclusive but provide some direction for credit unions.

Under each Standard you will find a list of resources. These include reference materials, organizations, and personnel that can help you assess whether or not your credit union complies with the Standard. These resources can also help you implement action plans to ensure the credit union's compliance with the Standard.

Section 1

Corporate Governance - Preamble

The care, diligence, skill, and prudence exhibited by a credit union's directors and General Manager/CEO have critical influence on the credit union's viability, safety and soundness, and its ability to achieve its business objectives.

Although the details of corporate governance may differ among credit unions, the foundations of good governance are directors and Chief Executive Officers who are concerned with, understand, and diligently discharge their responsibilities in a prudent manner.

Standard 1 Understand and Fulfill Directors' Responsibilities

A board of directors must understand its corporate governance responsibilities, meet those responsibilities, and regularly evaluate its effectiveness in fulfilling those responsibilities.

COMMENTARY

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

1. **Strategic Planning:** Considering, approving, and monitoring strategic business plans for the credit union.
2. **Risk Identification:** Recognizing, identifying, and evaluating the risks involved in a credit union's business operations.
3. **Succession Planning:** Ensuring that the board has a plan of succession to replace board members or the General Manager/CEO should they resign, retire, or pass away.
4. **Communications:** Ensuring that the credit union cultivates a system of effective and courteous communications among its members, board of directors, management group, other credit union employees, other stakeholders in the credit union system, and the general public.
5. **Systems Integrity:** Ensuring that business operations are functioning properly and effectively, and under a sound system of internal controls.
6. **Competent Management:** Ensuring that the board hires a qualified General Manager/CEO and appropriately oversees his or her activities.

Legislation and the common law determine certain responsibilities of the board, such as its duty to exercise due diligence and to avoid self-dealing. These Standards do not modify those responsibilities.

Rather, the Standards outline and describe expectations for effective governance. The board is accountable to the members of the credit union. It is responsible for directing and overseeing the credit union, and for taking reasonable steps to ensure that major issues receive proper consideration. The board must understand the credit union's business activities and the environment in which it operates. It must also select and direct the General Manager/CEO, and review the credit union's management performance, operating performance, and financial performance against expected results.

To help credit union directors understand their responsibilities, credit unions can implement new director orientation programs, training programs, and awareness programs. These programs can inform directors about new and on-going business developments, the credit union's changing risk profile, and regulation changes.

There are also actions a board can take that will help it assess its effectiveness. For example, some boards review on a regular cycle:

- The profile of qualifications, experience, and involvement required of directors;
- The quality and effectiveness of the board's performance;
- The processes they use for setting agendas and priorities;
- The quality and timeliness of materials provided for meetings; and

- The conduct of meetings; in particular, a board must ensure that issues relevant to the board's responsibilities are brought to its attention and dealt with promptly and effectively. The board must also ensure that directors have adequate opportunity to discuss and question issues.

POINTS TO CONSIDER

- Is the board satisfied that it is adequately informed about its responsibilities and accountability?
- Has the board established a budget 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?
- Has the board developed a set of qualifications and a cross-section of skill-sets and experience for board nominees?
- Does the board annually assess its own performance?
- Is the board satisfied that it is informed about all issues in an appropriate and timely manner?
- Does the board use a documented follow-up procedure to ensure that issues are resolved to its satisfaction?
- Do directors have adequate opportunities to question and discuss significant issues?

RESOURCES

- Credit Union Act; Sections 80 – 102
- CUSOURCE training
- Atlantic Central
- Self Assessment for Credit Union Boards
- CUDIC

Standard **2**

Understand Responsibilities of the Board Versus the Responsibilities of the General Manager/CEO

While ultimate accountability lies with the board, the board must understand how its responsibilities differ from the responsibilities of the General Manager/CEO.

COMMENTARY

When a board becomes involved in the daily operations of a credit union, the board relinquishes the right to hold management accountable for the results. The board and the General Manager/CEO must clarify and understand their respective roles to avoid conflicts and to enhance teamwork. The greatest benefits occur when the board and General Manager/CEO work closely together to shape the strategic plans and policies of the credit union.

Responsibilities of the Board

- Ensure that the board and General Manager/CEO develop and implement strategic planning processes;
- Review and approve credit union policies;
- Define the credit union's business objectives;
- Develop, consider, challenge, alter, and approve 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/CEO;
- Ensure that the General Manager/CEO assesses, reports, and manages risks appropriately;
- Ensure that the General Manager/CEO follows the credit union's policies, business plans, and all legislation that applies to the credit union;
- Monitor the performance of the General Manager/CEO regularly;
- Formally evaluate the performance of the General Manager/CEO annually; and
- Oversee member and community relations.

Responsibilities of the General Manager/CEO

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

POINTS TO CONSIDER

- Does the board clearly understand how its responsibilities mesh with the responsibilities of the General Manager/CEO?
- Does the board feel comfortable that the level of authority it has assigned to the General Manager/CEO is consistent with the accountability it expects from the General Manager/CEO?
- Does the board feel comfortable with how it oversees the activities of the credit union?
- Does the board's governance style incline toward "delegating and monitoring" or does it incline more toward "micro-management"?
- Would the General Manager/CEO agree with the board's assessment of its governance style?
- Does the board periodically discuss whether the balance of responsibilities between the board and General Manager/CEO is appropriate?
- Does the board ensure that policies are evaluated on a regular basis?
- Do the directors understand their fiduciary responsibilities to the credit union members?
- Does the board formally evaluate the performance of the General Manager/CEO at the end of each fiscal year?
- Does the board evaluate or take steps to ensure that the General Manager/CEO assesses, reports, and manages risks appropriately?
- Are benchmarks and objectives established for the General Manager/CEO?

RESOURCES

- Credit Union Act & Regulations
- CUSOURCE Training Programs
- Atlantic Central
- Self Assessment for Credit Union Boards

Standard
3

Exercise Independent Judgment

A board of directors must exercise independent judgement.

COMMENTARY

Directors are accountable to credit union members. A board of directors must exercise independent judgement 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/CEO.

A board and its General Manager/CEO must maintain a high level of trust and a good working relationship. Both the board and the General Manager/CEO must take care to ensure that the relationship is built on respect. However, the role of the board is to oversee and sometimes challenge its General Manager/CEO. 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/CEO 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/CEO's point of view.

POINTS TO CONSIDER

- Does the board occasionally consider and discuss the strengths and weaknesses of its working relationship with the General Manager/CEO?
- Does the board have an independent budget for its work; i.e., should the board decide they need outside consultants to provide guidance on a subject matter beyond their area of expertise.
- Does the board have an adequate level of autonomy from the General Manager/CEO and other senior managers?
- Does the board regularly hold *in camera* meetings for discussions in the absence of the General Manager/CEO?
- Does the board feel comfortable about making executive decisions, 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/CEO?

RESOURCES

- Credit Union Act & Regulations
- CUSOURCE training program
- Self Assessment for Credit Union Boards
- Atlantic Central
- CUDIC
- Credit Union External Accounting Firm
- Legal Counsel

Standard 4

Set Limits of Authority for Board Appointed Committees and General Manager/CEO

A board of directors must determine the duties, authority and limits, and accountability requirements of the board committees and the General Manager/CEO.

COMMENTARY

A board of directors may delegate some of its responsibilities to board committees or to the General Manager/CEO. The appointments of certain board committees (Audit and Credit committee) are mandatory. When the board delegates responsibilities to committees or to the General Manager/CEO, the board is still accountable for the results. Therefore, when assigning such duties, the board must clearly define the limits of authority for the committee or the General Manager/CEO. In turn, 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 the board committees and the General Manager/CEO?
- Are the board's assignments of responsibilities and authority up-to-date?
- Do the mandates of board committees address the committees' decision-making powers and reporting requirements?
- Do the mandates of the General Manager/CEO address the General Manager/CEO's decision-making powers and reporting requirements?
- Is there an established work plans for committees for the up coming year?
- Does the committee review its mandate on regular basis?
- Does the Board review authority granted to the General Manager/CEO on an annual basis?

RESOURCES

- Credit Union Act & Regulations
- CUSOURCE training program
- Self Assessment for Credit Union Boards
- Atlantic Central
- CUDIC
- Credit Union External Accounting Firm

Standard **5**

Select the General Manager/Chief Executive Officer

A board of directors must hire a General Manager/CEO who has the qualifications and competencies to provide effective and prudent management of a credit union.

COMMENTARY

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

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

When assessing the competence of a prospective General Manager/CEO, a board must consider the candidate's ability and integrity. Ability is measured by past performance and accomplishments. Integrity can be measured by the candidate's honest, sincere, and prudent performance of his or her duties. To verify the abilities and integrity of a General Manager/CEO candidate, a qualified human resources professional should conduct thorough performance and background checks.

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

The actions of the General Manager/CEO are accountable to the board. The General Manager/CEO is responsible for:

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

If the General Manager/CEO retires, resigns, or passes away, the board should consult its succession plan, just as the General Manager/CEO would refer to his or her succession plan if another senior manager suddenly became unavailable. This plan must ensure that a qualified senior manager takes over the interim daily operations of the credit union.

Points to Consider

- Is there an up-to-date position profile for the General Manager/CEO?
- Does the board have the experience and competence to establish selection criteria for the General Manager/CEO, or are external resources required?
- Does the board ensure its management recruitment agency conduct complete background checks to assess a candidate's competence?
- Does the board have a contractual arrangement with the General Manager/CEO, such as a special bonus plan or a separation contract?
- Does the board seek independent legal advice on contracts it might be negotiating with the General Manager/CEO?
- Is the succession plan relevant and up-to-date? When was it last reviewed?

Resources

- Credit Union Act & Regulations
- CUSOURCE training program
- Atlantic Central
- Business Consultant
- Legal Counsel
- Human Resource Professional (Head Hunter)

Standard 6 — Evaluate General Manager/CEO Performance

A board of directors must regularly evaluate the General Manager/CEO'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

Although a board of directors depends on the General Manager/CEO to run the credit union's daily activities, the board remains ultimately responsible for monitoring and assessing the General Manager/CEO'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/CEO's accountability to the board. By conducting General Manager/CEO evaluations, the board demonstrates that it is overseeing the General Manager/CEO's actions.

POINTS TO CONSIDER

- Has the board established performance evaluation criteria for the General Manager/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 objectives?
- 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/CEO performance evaluation criteria are applied competently and objectively?
- Does the board have the experience to critically and competently assess the performance of the General Manager/CEO, or should it seek professional assistance?
- Does the board understand the responsibilities and accountability the General Manager/CEO has assigned to the other senior managers?
- Has the board evaluated the General Manager/CEO's performance during the last 12 months?
- Has the board developed formal goals and objectives for the General Manager/CEO?

RESOURCES

- CUSOURCE training program
- Atlantic Central
- External Auditor
- Business Consultant
- Human Resource Professional

Standard

7

Review Compensation Programs

A board of directors must ensure that compensation programs are consistent with the credit union's business objectives, comply with the credit union's policies and processes, and do not increase the risks to which the credit union is exposed.

COMMENTARY

Appropriate compensation programs give the General Manager/CEO 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 (for example, hire professional advisors) to ensure that bonus plans do not encourage inappropriate risk-increasing practices.

POINTS TO CONSIDER

- Has the board developed a compensation philosophy that defines the programs it will use to attract & retain qualified employees?
- Has the board approved a compensation policy that the General Manager/CEO can use to compensate employees?
- Is the board satisfied that the credit union's compensation programs are designed to attract and retain qualified and competent individuals?
- Do the compensation programs suitably reflect the responsibilities of these positions?
- Is the board aware of the model system compensation program?
- Is the board satisfied that any performance-based compensation programs (bonus and variable-pay programs) acknowledge superior performance and do not encourage inappropriate risk-taking practices?
- Has the board or General Manager/CEO contracted professionals to perform a compensation study at regular intervals?
- Has the board negotiated a fair and equitable labour contract?

RESOURCES

- CUSOURCE training program
- Atlantic Central
- External Auditor
- Business Consultant
- Human Resource Professional
- Watson Wyatt
- Hay Group

Standard **8**

Set Benchmark for Ethical Business Conduct

A board of directors must approve policies of ethical business conduct for directors, the General Manager/CEO, and other employees. The board must also obtain evidence that the General Manager/CEO has developed and implemented procedures to promote compliance with those policies.

COMMENTARY

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

When a board defines expectations for ethical behaviour and evaluates its own compliance with these expectations, the board sets the benchmark for ethical business conduct. This benchmark is a key element in a board's effective oversight of the credit union.

POINTS TO CONSIDER

- Has the board considered and approved policies of business conduct and ethical behaviour for the board?
- Does the board understand what constitutes acceptable business conduct and ethical behaviour for a regulated deposit-taking institution in Canada?
- Do the policies of business conduct and ethical behaviour 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 business conduct and ethical behaviour?
- Do the policies include rules governing the hiring of family members of the board?
- Do board members receive a copy of the policies of business conduct and ethical behaviour when they are elected to the board?
- Are directors required to annually attest to their compliance with the policies?

RESOURCES

- Credit Union Act & Regulations
- CUSOURCE training program
- Atlantic Central
- External Auditor
- Business Consultant
- CUDIC

Standard 9 Conduct Strategic Business Planning

It is a sound business practise for the Board of Directors to:

- **Establish the business objectives of the credit union, develop, consider and approve the business strategy and business plans for significant operation, and review those at least once a year to ensure that they remain appropriate and prudent in light of current and anticipated business and economic environment, and resources;**
- **Evaluate frequently actual operating and financial results against forecast results, in light of the credit union's business objectives, business strategy and business plans;**
- **Obtain, on a regular basis, reasonable assurances that there is an ongoing, appropriate and effective strategic management process as referred to in *Standard #15 Manage Strategic Business Plans*.**

COMMENTARY

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. They also provide the parameters for assessing the credit union's programs and the General Manager/CEO's performance.

Although the board expects the General Manager/CEO 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 board must also evaluate the financial performance of the credit union to ensure that the General Manager/CEO is managing the plan effectively.

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

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

- The introduction or cessation 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

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

The *Strategic Planning and Management* section of this document addresses the process for managing the strategic business plan.

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 a day or more for a planning session each year?
- Is the board satisfied with its current involvement in the strategic business planning process?
- Do the plan's objectives appropriately balance the desire for sustainable returns and growth with the need for safety and soundness?
- Is the board satisfied that the plan will benefit the credit union?
- Is the board satisfied with the plan's reasonableness, its feasibility and achievability?
- Does the board have an effective means of determining the credit union members' needs and opinions on products and services?
- Is the General Manager/CEO measuring the right indicators to determine if the strategic plan is still appropriate?
- Does board receive at least quarterly updates on strategic business plan?

RESOURCES

- Atlantic Central
- CUSOURCE training program
- External Auditor
- Business Consultant (Facilitator)

Standard 10 Oversee Risk Management

A board of directors must be aware of the significant risks facing the credit union. The board must understand the actual and potential implications of those risks and evaluate them regularly. The board must also approve prudent policies to manage the risks, and obtain evidence that the General Manager/CEO has developed and implemented an effective risk management framework.

COMMENTARY

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. The credit union must also demonstrate appropriate, effective, and prudent management of these risks.

The *Risk Management* section of this document addresses this subject in detail.

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 fully understand the policies and have a reasonable understanding of procedures and controls used to manage significant risks?
- Is the board satisfied that the information it receives about the credit union's risk profile is timely, relevant, accurate, and complete?

RESOURCES

- Credit Union Act & Regulations
- CUSOURCE training program
- Atlantic Central
- Business Consultant
- CUDIC

Standard **11**

Oversee Capital Management

A board of directors must understand the credit union's capital needs and approve prudent policies for managing these capital needs. The board must also obtain evidence that the General Manager/CEO has developed and implemented effective processes to manage the credit union's capital needs.

COMMENTARY

Capital fulfills a number of important roles. It 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 engenders 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. The board must then obtain evidence that the General Manager/CEO is managing the credit union's capital effectively.

The board must ensure that its capital management policies do not create undue member expectations for redeeming or acquiring dividends on contributed capital, surplus shares, or preferred shares. For example, a credit union that cannot redeem or deliver a dividend on preferred shares when its members have been conditioned to expect it, can expect some significant negative reaction. (*Standard 24: Manage Capital* addresses the expected capital management process in detail.

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 that regulatory capital requirements represent the **minimum** level of capital?
- Does the board understand how retained earnings differ from contributed capital in terms of its ability to absorb losses and in terms of member expectations?
- Is the board aware of how operating decisions, fixed asset acquisitions, and new programs affect BIS (risk weighted) capital requirements? (Possible Future Feature)
- Does the board understand that operations which are conducted through subsidiaries require 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?

RESOURCES

- Credit Union Act & Regulations
- CUSOURCE training program
- Atlantic Central
- Business Consultant
- CUDIC

Standard
12 Oversee Liquidity and Funding Management

A board of directors must understand the credit union's liquidity and funding needs and approve prudent policies for the management of those needs. The board must also obtain evidence that the General Manager/CEO has developed and implemented effective processes to manage the credit union's liquidity and funding needs.

COMMENTARY

Liquidity is the availability of funds to honor commitments (on or off-balance sheet) 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.

Understanding liquidity and funding needs and obtaining accurate reporting and reasonable assurance that the liquidity and funding management process is appropriate and prudent enables the Board of Directors to satisfy itself that the credit union is in a position to manage its liquidity and funding and to meet obligations as they come due.

Standard 25: Manage Liquidity and Funding addresses these processes in detail.

POINTS TO CONSIDER

- Is the board aware of the regulatory and mandatory requirements for liquidity?
- Does the board clearly understand the risks that arise from not having adequate liquidity?
- 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?

RESOURCES

- Credit Union Act & Regulations
- Credit union's liquidity policy
- CUSOURCE Training Program
- Atlantic Central
- Business Consultant

Standard 13 Set the Benchmark for the Control Environment

A board of directors must support and encourage effective systems of internal control within the credit union. The board must also obtain reasonable assurance that the General Manager/CEO and other credit union employees place a high degree of importance on internal controls.

COMMENTARY

A credit union's control environment, or attitude toward internal controls, is reflected in the level of respect that the General Manager/CEO and the board of directors demonstrate for internal controls. The control environment of a credit union is shaped by:

- The board's governance approach;
- The General Manager/CEO's management style and example;
- The credit union's organizational structure;
- The amount of resources allocated to an effective control system;
- The emphasis on training employees to apply proper internal controls;
- Adherence to documented policies and procedures;
- The nature of the credit union's procedures and controls; and
- The employees' level of adherence to those procedures and controls.

The control environment strongly influences the effectiveness of risk management processes. The control environment also influences the employees' attitudes toward internal controls and their behaviour when complying with internal controls. Costly and embarrassing exposure to unwanted or unforeseen risk can be greatly reduced when a credit union exercises appropriate and effective control.

Standard 26: Manage Control Environment addresses internal controls in detail.

POINTS TO CONSIDER

- Is the board satisfied that its governance approach and control philosophy help establish 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?
- Does the board carefully consider the control weaknesses identified by regulators and external auditors?
- Does the board ensure that the General Manager/CEO corrects those control weaknesses?
- Is the board satisfied that information it receives about weaknesses or breakdowns in controls is timely, relevant, accurate, and complete?

RESOURCES

- Credit Union Act & Regulations
- CUSOURCE training program
- Internal Audit department
- Atlantic Central
- Business Consultant
- External Regulatory Reviews (i.e., CUDIC and Superintendent's office)
- External Auditors

Standard
14

Ensure Control Systems

A board of directors must obtain evidence that the General Manager/CEO has developed and implemented effective internal control systems, as described under Standard 26: Manage Control Environment. The board must also be alert for signs that controls are slipping and regularly evaluate whether the General Manager/CEO has the credit union firmly under control.

COMMENTARY

The General Manager/CEO 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, as steward of member deposits, has a responsibility to watch for "red flags" that indicate that control is slipping.

Some credit unions are large enough to hire an individual to act as internal auditor. Some credit unions may share an auditor with other credit unions. Others use an audit function composed of several employees who carry out the various duties that an internal auditor would perform. In all cases, the board must ensure that:

- The internal auditor or function has the mandate and sufficient resources to carry out assigned duties;
- The internal auditor or function has independence in carrying out assigned duties and can report to the board, audit committee, the General Manager/CEO, or to senior managers without fear of repercussion;
- The internal auditor or function verifies that the credit union is monitoring and complying with its processes, policies, procedures, and controls; and
- The General Manager/CEO takes appropriate action to address control weaknesses or breakdowns identified by the internal auditor, auditing function, or external sources.

An independent audit allows a board of directors to objectively validate whether the credit union's processes, policies, procedures, and controls are working. An internal auditor would logically report to the board's audit committee or directly to the General Manager/CEO. If the credit union is not large enough to hire an internal auditor, those who carry out audit procedures must report directly to the General Manager/CEO.

The size of a credit union and the complexity of the credit union are factors that determine whether an internal auditor should be hired and to whom the auditor should report. Whether an internal auditor is hired or not, a board must obtain evidence from its General Manager/CEO that the credit union's internal control systems are in place and are being carefully followed.

The board must understand and address control shortcomings that are identified by external sources such as regulators and auditors.

Points to Consider

- Has the board obtained evidence from external sources that the internal controls are adequate and competently managed?
- Has the board considered the need to set up an independent internal audit function that will report to the audit committee?
- Is the board satisfied that those who carry out internal audit functions have appropriate access to the operation?
- Is the board satisfied that those who carry out internal audit functions have complete independence in carrying out their responsibilities?
- Does the board carefully consider the control weaknesses identified by regulators and external auditors?
- Does the board ensure that the General Manager/CEO corrects those control weaknesses?
- Is the General Manager/CEO'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?
- Is the board satisfied with the frequency of the reports it receives about internal controls?

Resources

- Board packages comparing actual results with budgets and regulatory requirements
- Internal Audit completed by the Internal Audit or CUDIC
- Loan inspection reports completed by CUDIC
- Peer group comparisons provided by CUDIC
- CUSOURCE training
- Government Examination

Section 2

Strategic Planning and Management - Preamble

The planning, diligence, and prudence exhibited by a credit union's directors and General Manager/CEO have critical influence on the credit union's viability, soundness, and its ability to achieve its business objectives.

Oversight of the plan is imperative to success. Management must be able to positively demonstrate to directors that their vision is being applied in a successful manner.

Standard **15**

Manage Strategic Business Processes

The General Manager/CEO and senior management must ensure that the institution has an ongoing, appropriate and effective strategic management process.

COMMENTARY

The General Manager/CEO 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:
  - The implementation of the strategic business plan;
  - The 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 distribution channels that the credit union will use to conduct the business activity;
- 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; and
- The expected short- and long-term operating and financial results.
- The development and implementation of an annual business plan and budget.

The strategic business plan is the foundation on which a credit union should build new initiatives. The General Manager/CEO 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.

By identifying the significant risks in its strategic business plan, the board and General Manager/CEO can develop processes to mitigate the risks. By knowing the risks, the board and General Manager/CEO 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/CEO to:

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

POINTS TO CONSIDER

- Does the board challenge the assumptions used to develop the strategic business plan?
- Has the General Manager/CEO established criteria to evaluate the credit union's ability to achieve its business objectives?
- Has the General Manager/CEO identified and monitored the internal and external factors that may affect the strategic business plans?
- Does the General Manager/CEO regularly report on the credit union's progress toward the strategic business plans' objectives?

RESOURCES

- Atlantic Central
- Board packages comparing actual results with budgets and regulatory requirements
- Peer group comparisons provided by CUDIC
- Business Consultants
- Credit Union Central of Canada Environmental Scan

Section 3

Risk Management -Preamble

A credit union is exposed to a number of risks that can adversely affect its ability to achieve its business objectives. These risks can cause a credit union to lose earnings and capital, and can jeopardize a credit union's reputation. Credit unions, therefore, need comprehensive and disciplined risk management processes.

The objective of risk management is not to **eliminate** risk, but to **manage** it. Many risk management tools (such as hedging, securitization, and insurance) help to mitigate or transfer risk. Credit unions typically try to manage some risks (such as credit risk) within defined risk/reward tolerances, and other risks (such as operational risk) within expected threshold levels.

The details of risk management processes differ among credit unions, according to several factors. These factors include the size and complexity of the credit union's business activities, its significant risks, control environment, degree of centralization, experience and qualifications of management staff, and delegation of authority.

Risk management processes must correlate with:

- The credit union's business strategy and plans;
- The need to generate an appropriate level of sustainable earnings;
- The interrelationships among risk, reward, capital, and liquidity;
- The nature, size, and complexity of risks that accompany specific decisions; and
- Regulatory requirements.

In order for risk management to be effective:

- Accountability for risk management must start at the highest level within the credit union - at the board level;
- The General Manager/CEO must ensure that risk management processes anticipate risks and do not simply react to them;
- The General Manager/CEO must ensure that risks are identified consistently and clearly defined, and that he or she understands these risks;
- The board and General Manager/CEO must ensure that they establish clear lines of responsibility for managing risks; and
- The General Manager/CEO must ensure that risk management processes are integrated with all management and business activities.

Standard **16**

Implement Effective Risk Management

The General Manager/CEO and senior management must ensure that the credit union has an ongoing and effective enterprise risk management process.

COMMENTARY

The General Manager/CEO must develop and implement effective processes to:

- Identify risks inherent in the credit union's current and anticipated operations;
- Develop and submit risk management policies for board approval;
- Review risk management policies regularly to ensure they remain appropriate;
- Implement and manage risks within approved policies;
- Establish appropriate and effective procedures and controls to manage the risks;
- Monitor the credit union's performance in implementing the 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 apply to Standards 17 to 23, which describe the types of risks to which a credit union can be exposed.

Risk Management Processes: The General Manager/CEO 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/CEO 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;
- Risks over which the credit union has influence but limited control; and
- Risks over which the credit union has influence and significant control.

Risk Assessment: To ensure that risk management processes are effective, a General Manager/CEO must assess the potential impact of identified risks. The General Manager/CEO 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/CEO must ensure that the credit union's policies are appropriate to the potential impact of its risks. The General Manager/CEO 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/CEO 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/CEO 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/CEO 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;
- Understand the consequences of managing risks inappropriately; and
- Assume responsibility for the risk management processes and not pass the responsibility to others.

To ensure employees understand their accountability, a General Manager/CEO 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.

A credit union's policies and processes, if well designed and applied, can provide a board some assurance that the risk management objectives are being met. However, there are inherent limitations in all systems. Human judgement can be faulty, breakdowns can occur because of mistakes, and rules can be circumvented. Therefore, **the General Manager/CEO must manage risks within an effective control environment.**

Risk Management Reporting: To manage risks effectively, a General Manager/CEO must report the following to the board of directors:

- 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.

When a General Manager/CEO reports the credit union's risk management processes effectively to the board, the board can oversee the credit union's risk management policies, business strategy, and business plans. Independent audits will either confirm or contradict the General Manager/CEO reports.

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/CEO 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 service providers and their services?
- Does the General Manager/CEO shock test the risk management process to analyze 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/CEO proposed, and the board considered and approved, a disaster recovery (business continuity) plan for the credit union?
- Does the board periodically review the Business Continuity Plan?

RESOURCES

- Loan risk rating
- CUSOURCE training
- CUDIC
- Peer group comparisons
- Atlantic Central
- Business Consultant
- External Auditor

Standard 17

Manage Credit Risk

Credit unions are continually exposed to significant credit risk. Loan policies are based on a credit-granting philosophy defined by the board. The General Manager/CEO must develop and submit for board approval, appropriate and prudent policies on:

- **Types of credit in which the credit union is prepared to engage or will not engage (on, or off-balance sheet);**
- **Credit concentration limits for borrowers, groups of associated borrowers, industrial sectors, economic sectors, or geographic regions; and**
- **The management and control of loan default risks, including the management of property for resale.**
- **Risk Tolerance Levels**
- **Underwriting Standards**

The General Manager/CEO must also ensure that he or she manages significant credit risks within established policy limits. The General Manager/CEO must manage these risks by implementing appropriate and effective:

- **Levels of decision-making authority for approving credit;**
- **Processes for evaluating individual credit risks;**
- **Processes to evaluate and rate the credit union's total credit risk;**
- **Processes to manage higher risk credits that warrant special attention;**
- **Methods for promptly recognizing, estimating, and recording credit impairments; and**
- **Methods for minimizing loss when resolving distressed loans/asset liquidation situations.**

COMMENTARY

Credit risk exists in many of a credit union's business activities, including traditional lending and extending credit.

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 practice. The board and General Manager/CEO must diversify the credit union's exposure to credit risks in order to maintain the credit union's safety and soundness. There are many levels of exposure to credit risk. 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;
- A group of industrial or economic sectors that are interrelated; or
- A geographic region.

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.

Credit Approval Authority: The board and General Manager/CEO 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 Rating System: Credit risk rating systems help a board and General Manager/CEO to identify and control risk. Using credit risk rating systems as a basis, the General Manager/CEO 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 and Rating 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;
- The borrower's geographic location; 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/CEO can manage credit risk by ensuring that the credit union's lenders effectively evaluate and rate the credit worthiness of borrowers. By using effective evaluation and rating processes, a lender can:

- Make more effective credit decisions;
- Align credit pricing with risk/return expectations;
- Analyze and control the quality of the credit portfolio;
- Analyze 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/CEO 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 starts to deteriorate.

Credit Impairment Recognition: The General Manager/CEO must implement an orderly method for 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
- A general reserve requirement

Points to Consider

- Have the board and General Manager/CEO provided enough resources (such as money, information, training, processes, and technology) for employees to execute and manage the credit risk for the credit union?
- Are the employees competent enough to manage credit risk?
- Has the board adopted a policy that sets credit concentration limits for the credit union?
- Does the General Manager/CEO track and report credit concentration statistics?
- Can the credit union board and General Manager/CEO demonstrate the prudence of the credit union's loan policies?
- Does the General Manager/CEO ensure that loans are consistently risk rated?
- 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?

Resources

- Credit Union Act & Regulations
- CUDIC
- Atlantic Central
- Loan audit reports completed by CUDIC
- North American Industry Standard codes
- Credit union's loan policy
- Credit union's allowance for impaired accounts report

Standard
18

Manage Asset/Liability Risks

Because of the way its assets and liabilities are structured, a credit union is exposed to risk. The General Manager/CEO must develop, and submit for board approval, appropriate and prudent policies on the types and extent of asset/liability risk the credit union is willing to assume.

The General Manager/CEO must also ensure that the credit union manages its asset/liability risks within the established policy limits by:

- **Defining levels of authority for managing asset/liability risks;**
- **Measuring asset/liability risks; and**
- **Evaluating how the credit union responds to economic changes, such as rising or falling interest rates. Evaluation techniques should include stress and shock testing.**

COMMENTARY

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 a 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/CEO 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 earnings, capital, and liquidity are not adversely affected.

Asset/Liability Risk Management Policies: The General Manager/CEO 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.

Asset/Liability Risk Management Processes and Controls: A credit union's asset/liability risk management processes must fit the nature, size, and complexity of the credit union's exposure to asset/liability risk.

To manage asset/liability risk, the General Manager/CEO must clearly understand the amount at risk as well as the factors that impact the risk. The General Manager/CEO must act promptly and appropriately when the credit union is exposed to risk. The longer it takes for the General Manager/CEO to reduce unwanted exposure, the greater the possibility of an undesired outcome.

Hedging is a technique that a credit union can use to manage asset/liability risk, but must be used with caution. The General Manager/CEO must consider which risk management technique is appropriate, given the nature and extent of the risk exposure.

Before using hedging instruments (such as swaps), the General Manager/CEO must thoroughly understand the products and should seek the advice of the experts at Atlantic Central. The General Manager/CEO must also ensure that the hedging products match the credit union's specific needs and are cost-effective.

POINTS TO CONSIDER

- Have the board and General Manager/CEO provided enough resources (such as money, information, training, processes, and technology) for employees to execute the asset/liability risk strategy and manage the risk?
- Are the employees competent enough 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/CEO developed and implemented foreign exchange risk policies?

- Can the General Manager/CEO provide sound reasons to demonstrate the prudence of the credit union's asset/liability policies?
- Do the systems that management has developed to obtain and track information enable the General Manager/CEO to make timely adjustments to the mismatch risk strategy?
- Have the board and General Manager/CEO developed and implemented asset/liability matching and interest rate swap policies?
- Does the General Manager/CEO consult with Atlantic Central prior to entering swap agreements?

RESOURCES

- Credit union's asset/liability management policies
- Credit Union Act
- CUDIC
- CUSOURCE
- Atlantic Central ALM Service Bureau

Standard 19

Manage Fiduciary Risk

The General Manager/CEO must develop, and submit for board approval, appropriate and prudent policies on the types and extent of fiduciary activities the credit union has assumed.

The General Manager/CEO must also ensure that he or she:

- **Complies with all laws and regulations governing fiduciary services;**
- **Counsels and advises members appropriately, according to the risk tolerances and reward expectations of those members;**
- **Prudently deals with assets that are held, administered, or invested on behalf of other parties;**
- **Deals with those assets according to agreements made between those parties and the credit union; and**
- **Protects the credit union members' personal and financial data from misuse by unauthorized individuals.**

COMMENTARY

Business activities that carry fiduciary risk can include:

- Brokerage activities;
- Investment planning and other advisory services;
- Trust and estate administration;
- Agency activities;
- Mutual or investment funds management;
- Pension 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/CEO must carefully consider and manage the credit union's exposure to fiduciary risk to maintain its safety and soundness. Proper completion of an ERM framework will address many of these issues.

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/CEO 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 applicable laws and regulatory requirements?
- Has the credit union trained employees on their responsibilities under the law?
- Are the employees competent enough to fulfill those responsibilities?
- Does the credit union have sufficient resources to manage fiduciary risk?
- Do the systems that management has developed to obtain and track information enable the General Manager/CEO to make timely adjustments to the fiduciary risk strategy?
- Is there a compliance regime in place for wealth management, privacy and money laundering?

RESOURCES

- CUSOURCE
- Compliance manuals
- Atlantic Central
- External Auditor

Standard 20 Manage People Risk

The General Manager/CEO must develop, and submit for board approval, appropriate, prudent, and relevant human resource policies. The General Manager/CEO must also ensure that the policies are regularly reviewed so that they remain current.

The General Manager/CEO must also ensure that:

- **The credit union has effective human resource recruitment, performance management, and employee retention programs;**
- **The levels of decision-making authority delegated to managers and other employees are reasonable and prudent;**
- **Credit union employees receive clear and concise communication about their individual responsibilities;**
- **Credit union employees acknowledge their responsibilities;**
- **Credit union employees are appropriately supervised; and**
- **The duties of credit union employees are segragated so that appropriate internal controls are maintained.**

COMMENTARY

A credit union may be exposed to people risk when:

- Credit union employees do not have adequate skills or knowledge;
- The credit union does not provide training that will enable employees to develop their professional skills;
- The credit union provides employees with compensation, bonuses, or incentives that are improperly matched to performance goals;
- The credit union’s 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
- The 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/CEO 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 responsibilities 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/CEO 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/CEO 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 do 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/CEO can effectively manage people risk and maintain a positive control environment. The CEO/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. All credit union employees must carry out their responsibilities in an appropriate manner. The employees also need to feel comfortable in reporting significant issues or adverse events to their supervisors or the General Manager/CEO.

Segregation of Duties: To effectively segregate the duties of credit union employees, the General Manager/CEO 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/CEO 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. In doing so, the General Manager/CEO stands a reasonable chance of minimizing and detecting errors or misappropriation of funds.

POINTS TO CONSIDER

- 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/CEO gives employees enough access to training programs, which provide them with an adequate level of skills and knowledge to effectively carry out the credit union's business?
- Is the board satisfied that the General Manager/CEO is effectively supervising the credit union's employees?
- Is the board satisfied that the General Manager/CEO has established proper limits of authority?
- Is the board satisfied that the employee's responsibilities and decision-making authority have been clearly communicated, in writing, to credit union employees?
- Is the board satisfied that the employees have acknowledged their responsibilities and decision-making authority?
- Has the board asked Atlantic Central's human resource consultants or other professionals to conduct an employee opinion survey within the past five years?

RESOURCES

- Atlantic Central
- Business Consultants
- Internal audit Department
- Reports completed by CUDIC
- Credit union's training schedule
- Credit union's HR policy
- CUSOURCE

Standard 21

Manage Procedural Risk

The General Manager/CEO must develop appropriate and prudent procedures to ensure the credit union follows generally accepted financial institutions processes. The General Manager/CEO must also ensure that the policies are regularly reviewed so that they remain current.

The General Manager/CEO must ensure that the credit union:

- **Appropriately documents its policies and procedures;**
- **Uses accounting principles and valuation methods that ensure its assets and liabilities are properly valued;**
- **Has accurate and complete financial information, business records, member data, and information about credit union operations;**
- **Uses effective management information systems.**

COMMENTARY

Documentation of Policies, Procedures, and Processes: By documenting significant business activity and risk management processes, the General Manager/CEO can ensure that appropriate controls are in place to reduce the occurrence of undetected errors or misconduct. Proper documentation helps the General Manager/CEO 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/CEO 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/CEO must employ a current, accurate, and meaningful management information system in order to make informed decisions and effectively communicate 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/CEO 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/CEO 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/CEO satisfied that the credit union has effective and accessible documentation that can help employees meet their responsibilities?
- Is the board/General Manager/CEO satisfied that the system of accounting for the credit union's assets and liabilities is effective?
- Is the board/General Manager/CEO satisfied that the credit union's assets and liabilities are properly valued?
- Is the board/General Manager/CEO satisfied that the management information systems allow all decision-makers access to current, accurate, and meaningful information?

RESOURCES

- Credit union's external auditors
- Atlantic Central
- Canadian Institute of Chartered Accountants Handbook
- Human resource professionals in the marketplace
- Business Consultants
- Reports completed by CUDIC
- Auditor's management report
- CUSOURCE

Standard 22 Manage Outsourcing Risk

The General Manager/CEO must develop appropriate and prudent systems to ensure the credit union uses suitable assistance to complete tasks that the staff either can not or should not execute. The General Manager/CEO must also ensure that the policies are regularly reviewed so that they remain current.

If the credit union relies on external contractors to provide service, the General Manager/CEO must develop and implement effective processes to:

- **Select capable and reliable service providers;**
- **Monitor the providers' performance;**
- **Enforce appropriate standards of service quality, accuracy, security, and response time;**
- **Ensure the quality and security of external services, including independent auditing and testing; and**
- **Ensure that electronic banking products provided by external contractors meet the credit union system's information technology (IT) standards for safety, security, and connectivity.**

Commentary

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; and
- Interruption of service due to financial or other difficulties experienced by the external contractors.

A credit union must be particularly prudent when hiring external services to set up and maintain an in-house banking system. The credit union must carefully control and monitor access to the system. In particular, it must log and audit all access by external contractors such as software and hardware suppliers.

Standard 23: Manage Technology Risk discusses in-house banking systems in detail.

Points to Consider

- Does the credit union have adequate procedures and controls to ensure high quality and reliable service from external contractors?
- Is the board satisfied that the credit union's outsourcing activities do not subject the credit union to contingent liability?
- Is the board satisfied that disruptions to the external contractor's business will not likewise cause business disruptions at the credit union?

- If so, is the board 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 specialists 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?

RESOURCES

- Atlantic Central
- CUDIC
- Independent consultants
- External audit firms
- Management consultants in the marketplace

Standard
23

Manage Technology Risk

The General Manager/CEO must develop appropriate and prudent procedures to ensure the credit union follows generally accepted technology for financial institutions. The General Manager/CEO must also ensure that the policies are regularly reviewed so that they remain current.

The General Manager/CEO must:

- **Adapt the credit union's technology to its business strategy, business plans, and operating needs;**
- **Properly authorize, test, and document technology changes before implementing them;**
- **Obtain confirmation from external IT specialists that (where the technology relates to the credit union's in-house banking system) the banking system is secure;**
- **Obtain confirmation from external IT specialists that procedures used to run the banking systems are adequate before the systems are implemented;**
- **Implement effective security systems and processes to protect the integrity of technology;**
- **Implement effective security systems and processes to protect the information that the technology records, processes, reports, and stores;**
- **Implement effective security systems and processes to protect sensitive and private member information, and prevent unlawful use of this information;**
- **Implement effective backup processes, recovery processes, and standby arrangements when critical technology is unavailable (for example, when access is interrupted or when technology is destroyed); and**
- **Allocate appropriate resources (money, people, and training) to maintain and enhance the technology.**

COMMENTARY

Credit unions depend on information technology (IT) to operate their business. Some of the credit unions' IT needs include computer hardware, computer software, digital data files, and IT professionals. Credit unions also invest heavily in information technology. These 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, in turn, can cause a loss in business and in member confidence.

A credit union's databases face the risk of being "hacked", or accessed without authorization. Because of the obvious financial incentives, financial institutions face an increasing number of attacks from computer hackers. To avoid being hacked, a credit union must protect its member data and member funds.

The General Manager/CEO 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/CEO 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/CEO must periodically review and stress-test the standby arrangements.

League Data is a supplier of such services as Interac, 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. However, if a credit union uses an in-house banking system, it must ensure that the appropriate certifications are performed and all changes to its banking system and local switch systems are tested and certified before implementing the changes. 5900 Audits should be performed regularly.

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/CEO 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/CEOs must therefore ensure that their in-house banking systems are subjected to external security audits at least annually and that they meet all reporting requirements and performance standards established by licensing authorities.

POINTS TO CONSIDER

- Is the board satisfied that the credit union's technology is appropriate for the needs of the credit union and is cost-effective?
- Is the board 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 the changes?

- Is the board satisfied that the credit union does not have modems in computers that are connected to the credit union's network and therefore to the credit union's banking data centre?
- Is the board satisfied that the credit union members' Internet access to their accounts flows through a network security system?

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

RESOURCES

- Independent IT consultants
- External audit firms – 5900 audit
- League Data
- CGI

Section 3

Capital, Liquidity and Financial Management-Preamble

Financial Management of the credit union is an area that must receive constant oversight.

The Board and General Manager/CEO must continually, ensure Capital- Equity is maintained at proper levels for use in emergency or simply to make adjustments to the direction the credit must take due to the ever changing world they find themselves a part of.

Also, the ability to raise and maintain deposits is critical to the continued operation of the credit union.

Standard
24

Manage Capital

The General Manager/CEO must develop, and submit for board approval, appropriate and prudent policies on the quantity and quality of capital that is appropriate for the credit union's risk exposure and regulatory requirements.

The General Manager/CEO must also ensure that the credit union:

- **Develops and implements effective processes to measure and monitor its capital requirements and capital position;**
- **Develops and implements capital planning processes that comply with regulatory and internal capital requirements; and**
- **Provides the board of directors with accurate, timely, and meaningful reports on the credit union's capital management processes and capital position.**

COMMENTARY

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 fulfills a number of important roles. It is a necessary financial resource that supports credit union operations and acts as a safety net against unanticipated losses. Capital also 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 engenders confidence.

The General Manager/CEO 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/CEO 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/CEO 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/CEO 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.

A credit union's capital consists of several components: retained earnings, common shares, surplus shares, and sometimes, preferred shares. When a board and General Manager/CEO analyze the credit union's capital, they must consider the extent to which its components can absorb losses. Capital with the highest capacity to absorb losses is:

- Permanent;
- Free from mandatory fixed charges against earnings (return on capital investments must be at the discretion of the board); and
- Subordinate to the rights of depositors and other creditors.

The capital component with all three qualities should be the dominant component of total capital. In credit unions, the most secure form of capital is retained earnings. Therefore, the primary focus should be on building retained earnings and not surplus shares or preferred shares.

A credit union must comply with regulations when determining the quantity and quality of its capital. The credit union must ensure that its capital can support the significant risks it faces. The credit union must also ensure that these risk levels are monitored and reviewed at a frequency that matches the nature, size, and complexity of the credit union's operations.

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/CEO must develop processes for assessing and fulfilling the credit union's anticipated capital needs.

By anticipating its capital needs, a credit union can take opportunities to raise capital on favourable terms and reduce the possibility of an adverse situation.

The board and General Manager/CEO must establish a capital management plan in order to:

- Project the credit union's capital requirements and capital position according to its business objectives, strategy, and plans.
- Identify the reasons behind the projections of capital requirements;

- Identify the quantity, quality, and sources of additional capital required; and
- Estimate the financial impact of raising additional capital.

When projecting the credit union's capital requirements and position, the board and General Manager/CEO 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 management processes.

A credit union must also coordinate its capital management processes with its risk management processes. Effective capital management processes allow the credit union to successfully develop and sustain profitability.

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?
- Does the board understand the minimum regulatory for capital?
- Does the board understand how retained earnings differ from contributed capital in terms of its ability to absorb losses and in terms of member expectations?
- Is the board aware of the implication on operating decisions, fixed asset acquisitions, and new programs on BIS (risk weighted) capital requirements?(Possible Future Program)
- Does the board have a policy governing the maximum level of fixed assets for the credit union?
- Has the board considered whether or not its capital management policy may create undue member expectations for dividends on, or the ability to withdraw, contributed capital, surplus shares, and preferred shares?

RESOURCES

- Credit union's board packages
- Credit union's planning session documents
- Atlantic Central
- CUSOURCE
- Credit Union Act & Regulations

Standard 25 Manage Liquidity and Funding

The General Manager/CEO must develop, and submit for board approval, appropriate and prudent policies for liquidity management and funding management. Policies for liquidity management must address sources, types, and levels of liquidity. Funding management policies must ensure that funding is not unduly concentrated by source of funding, type of funding, length of term to maturity, or currency.

The General Manager/CEO must also ensure that the credit union:

- **Manages its liquidity and funding according to established policies;**
- **Manages its liquidity and funding such that funds will be available to honour all cash commitments; and**
- **Provides the board of directors with accurate and timely reports on its liquidity management processes, funding management processes, and liquidity position.**

COMMENTARY

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, and deposits are the principal source of liquidity funds. Effective liquidity and funding management is a basic component of sound business practice.

A credit union's operational liquidity must meet anticipated day-to-day cash commitments and regulatory liquidity requirements.

Usual 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 (which may not be legally cashable if needed);
- 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 for some credit unions. To manage its liquidity effectively, a credit union must diversify its 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.

These liquidity risks may adversely affect a credit union, especially if it relies heavily on brokered or wholesale deposits. Deposit brokers improve the efficiency of money markets by permitting some depositors to make deposits more easily and at competitive interest rates. Deposit brokers also enable credit unions that do not have extensive branch networks to compete by eliminating the overhead costs associated with branches.

Despite the benefits of brokered or wholesale deposits, a credit union must not rely on them because undue reliance exposes the credit union to risk. The market for such deposits is highly competitive. A slight decrease in the credit union's interest rate will cause the depositors to invest in more attractive alternatives offered by the broker. This unreliability is why such funds are commonly referred to as "hot money".

If a credit union relies on brokered or wholesale deposits, it must develop a plan to manage the associated risks.

Process Considerations: To manage liquidity effectively, a credit union must consider anticipated as well as known liquidity and funding requirements. The General Manager/CEO must monitor these requirements. The General Manager/CEO must also assess the potential implications of these requirements and weigh alternative strategies. Such assessments provide evidence that liquidity and funding will be available to meet the credit union's needs. A number of methods may be used to monitor and assess liquidity. General Manager/CEOs must ensure that the chosen method or methods are appropriate to the credit union's circumstances.

In order to anticipate liquidity requirements, the General Manager/CEO must evaluate foreseeable changes in economic, political, regulatory, or other conditions facing the credit union. Since this evaluation is partially based on assumptions, the General Manager/CEO must be able to support the assumptions and review them on a regular basis to ensure their continuing validity.

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/CEO regularly review the projections of the credit union's liquidity needs to ensure that they remain valid?

RESOURCES

- Credit union’s liquidity policy
- Atlantic Central
- Credit Union Act & Regulations
- CUSOURCE

Section 4

Control Environment - Preamble

Internal controls are required not only to ensure policies and procedures are carried out in an efficient manner but to ensure every effort is made to ensure the safety of members funds.

Fraud is a very real risk in the financial services industry and one risk that can and must be controlled. This risk will never be eliminated but a good internal control structure will assist the Board and Management in managing the risk at acceptable levels.

Standard 26 — Manage Control Environment

The General Manager/CEO must develop, and submit for board approval, appropriate and prudent policies for mitigating risk within the credit union. Policies must address who is responsible and what procedures must be observed in all areas of the operation. Accountability is paramount for effective oversight in this area.

The General Manager/CEO must take steps to ensure that:

- **The credit union has appropriate and effective internal control systems;**
- **The credit union employees are trained to respect the internal control systems;**
- **The credit union employees are aware that the controls protect them from being wrongfully accused if a theft occurs or money disappears;**
- **The internal control systems are regularly monitored;**
- **Employees are personally protected from repercussions if they see and report control weaknesses;**
- **The internal audit and/or independent external audit review confirms that internal control systems are effective;**
- **Observations from external sources about the credit union's internal control systems are seriously considered;**
- **Weaknesses or breakdowns in internal control systems are addressed;**
- **The board of directors receives accurate, timely, and meaningful reports on the credit union's internal control systems; and**
- **The board of directors receives regular reports on any deficiencies in these systems and receives evidence that the General Manager/CEO has taken action to address them.**

COMMENTARY

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/CEO 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/CEO can obtain evidence that they are "in control" from several sources:

- **The audit committee:** An audit committee is required under legislation. The audit committee meets with the credit union's external auditors. It may also receive reports from the internal auditor or other employees who perform internal audit duties.

- **The internal auditor or internal audit function:** The purpose of the internal auditor or internal audit function is to evaluate the extent and effectiveness of the systems of control.
- **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/CEO 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 and 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. Internal audits are performed using resources within the credit union. To be effective, those who perform internal audits must:

- Independently report to the board of directors, the audit committee or the General Manager/CEO;
- 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/CEO 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/CEO and other senior managers encourage open communication about control issues within 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 controls?
- Does the independent inspection/audit function regularly validate the quality and integrity of the control systems?
- How and to what extent do the board and General Manager/CEO consider observations from external sources about the management of the credit union's operations and risks?
- Does the General Manager/CEO 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

- Audit committee reports
- Internal audit reports
- Audit completed by CUDIC
- Auditor's management letter
- CUSOURCE
- Atlantic Central
- External Auditor
- Independent Consultants
- Provincial Compliance Officer reports

Standard 27

Ensure Business Conduct and Ethical Behavior

The General Manager/CEO must develop, and submit for board approval, appropriate and prudent policies for overseeing the conduct of directors as well as employees. These policies would include but not be limited to, Conflict of Interest, Confidentiality, and Ethical Behaviour both inside and outside of the credit union.

The General Manager/CEO must:

- **Develop and submit for board approval appropriate and prudent standards of business conduct and ethical behaviour for the credit union's employees; and**
- **Provide evidence to the board that the credit union has an ongoing, appropriate, and effective process for ensuring that the employees comply with the standards of business conduct and ethical behaviour.**

COMMENTARY

The standards for business conduct and ethical behaviour, 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/CEO must ensure that employees are educated about and comply with these standards.

The Board, General Manager/CEO 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 business conduct and ethical behaviour for the credit union employees?
- Do the standards include definitions of "conflict of interest"?
- Is the board aware of any credit union employees with business interests or investments that could be viewed as a conflict?
- Do the policies include rules governing General Manager/CEO or senior manager ownership of private business interests?
- Do the policies include rules governing the hiring of family members and friends of the General Manager/CEO or other managers employed by the credit union?
- Are employees of the credit union given a copy of the policies of business conduct and ethical behaviour when they are hired?
- Are the General Manager/CEO and other employees required to annually attest to their compliance with the policies?

- Do the credit union's policies of business conduct and ethical behaviour address matters that affect the reputation of the organization (such as conflicts of interest and adherence to governing laws and regulations)?
- Is the board satisfied that the behaviour of the employees complies with the policies for business conduct and ethical behaviour?
- Is there a process for dealing with non-compliance with the policies?

RESOURCES

- Credit union's Human Resource Policy
- Credit union's Conflict of Interest Guidelines
- Credit Union Act & Regulations
- CUSOURCE
- Atlantic Central
- Independent Consultants
- External Auditors
- Credit union's closed account reports – member comments