Below is a summary of questions/issues we have thus far with specific provisions of the draft rule.

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| **1: Categorization of oversight functions versus senior management** | |
| **SBFP draft rule section** | **Questions & required clarifications** |
| **Section 1(1) (iii) and (iv**)  Oversight functions are defined separately and distinctly from senior management with oversight including: a) internal audit, b) risk management, c) compliance and d) finance.  Senior management includes: a) CEO, b) individuals responsible for overall management, c) heads of oversight functions, etc | **Questions/clarifications:**  This section combined with S1(5), seems to expand oversight and independence beyond the internal audit function and categorizes CRO and CFO (as examples) in a way that separates them from senior management.  What is the correct interpretation of the oversight categories versus senior management? Does oversight function responsibility include the oversight of senior management/senior management activities?  How does the oversight function align with or differ from the responsibility of the CEO for overseeing operations, risk management and financial performance of the Credit Union. how does the oversight function role align with or differ from the Board’s responsibilities?  If the oversight function is expected to oversee senior management, how can heads of oversight functions also be categorized as senior management? Doesn’t this contradict the concept of independence defined in S. 1(5) (i), (ii) and undermine oversight – how do they oversee themselves?  How does the creation of the oversight functions (beyond internal audit function) align with the sound business practice and principles of ensuring a strong first, second and third lines of defense? For example, internal audit is a third line of defense and is independent from the business operations it oversees. This function, in the DUCA context and many regulated FIs, has a functional reporting line to the board and therefore is not a member of senior management. this ensures effective third line of defense and independence. Under S 1 (iv) the head of this function is also included in the senior management category- doesn’t this undermine head of internal audit’s independence? On the other hand, the nature of CFO and CRO roles by design, are not independent of the business operation, as this serves to ensure a strong second line of defense.  To comply with this section would the credit union need to reorganize the org. structure to remove the operational decision making and management activities from the CRO and CFO to make them independent of the operational activities they oversee (as per S.10(5) of this rule?). Pertaining to the CRO, if this function must report directly to the board, then presumably all the operational management/decision making of this role will need to be reorganized elsewhere to ensure the board isn’t violating the CUCPA S.97 (1) and (2) prohibition? |
| **Section 1(5) (i), (ii)**  1(5) (i): Whether an individual or entity is independent is exclusively a question of fact.  1(5) (ii): Independent individual is free from influences that compromise judgment, allowing individual to act with integrity, and exercise objectivity and professional skepticism. | **Questions/clarifications:**  How do we interpret (i)? does this mean other facts separate from criteria listed in (ii)? what facts might apply?  Would heads of oversight functions (eg: CRO, CFO) that report to the CEO be considered not independent? |
| **2: Responsibilities of Board versus CEO / Senior Management** | |
| **SBFP draft rule section** | **Questions & required clarifications** |
| **Section 5(2), (3)**  5(3): The board of the credit union is responsible for providing oversight, supervision and direction to management and shall oversee and approve:  5(3) (i):  (a) through (f)  (g) mandates & budgets for oversight functions  (h) risk management  5(3) (ii): the appointment, setting of performance objectives, compensation, incentives, succession plans and reviews of the credit union’s CEO and other members of senior management including the heads of oversight functions, in accordance with 9(1)  (iii) delegations of authority by the board and by the credit union’s senior management | **Questions/clarifications:**  Re: S.5(3): “direction to management” is broad in scope and needs further clarity. If the board is responsible for directing management broadly how is this consistent with the CUCPA’s prohibition on the board from directly managing or being involved in the day-to-day activities of the credit union as per CUCPA S.97(1) & (2)? How does this section support a clear division of roles and responsibilities between board, CEO/ senior management as per S.5(2) of the rule?  Re: S.5(3)(i)(h): is it the correct interpretation that the board is responsible directly for risk management? Does this mean the CRO must functionally report to the board? In this context, how does the board avoid violating the CUCPA prohibition set out in S.97(1) & (2) of the act? The CRO is directly involved in day-to-day operations – eg: loan underwriting and credit adjudication decisions (as only two of many examples). How does this support clear division of roles and responsibilities between board, senior management and CEO?  Re: S.5(3) (ii): is it the correct interpretation that “appointment” means the final hiring and/or personnel retention decision? Is it the correct interpretation that the statement: “…and other members of senior management including heads of oversight functions.”, means the board has the final decision on hiring/performance objectives/etc, for all senior management and this includes the CFO and CRO? The CEO does not have final decision rights on hiring or performance objective setting for any of their senior team?  If the interpretation re: S.5(3)(ii) above is correct – how can the board comply with the CUCPA prohibition set out in S.97(1) & (2) of the act if they are setting performance objectives? Performance objectives define priorities, work-plans and the actions of management in the day-to-day operating of the credit union. What responsibility/authority remains for the CEO in terms of hiring decisions, establishing annual objectives and work priorities if this becomes the responsibility of the board? |
| **3: Remuneration** | |
| **SBFP draft rule section** | **Questions & required clarifications** |
| **S.9:**  S.9(4): The credit union shall ensure its remuneration programs, policies and practices referred to in subsections 9(1), 9(2) of this rule, are consistent with the following:  (i) employees engaged in the oversight functions are remunerated in a manner that is independent of the business areas they oversee and commensurate with their key role in the credit union | **Questions/clarifications:**  Re: S.9(4)(i): what is the correct interpretation of “independent of business areas they oversee”?  How can this be put into practice? For example, CFO and CRO are both directly involved in decision making and managing the business operation. This practice exists to support a strong and effective second line of defense and enables risk management and financial stewardship thinking and discipline throughout the organization and decision-making. Does this mean CFO and CRO cannot have a variable incentive/bonus based on overall business performance metrics? If this is correct, how does this support the alignment of incentives with board approved performance goals for the credit union? |
| **4: Oversight functions** | |
| **SBFP draft rule section** | **Questions & required clarifications** |
| **S.10:**  S.10(1):The credit union shall establish and maintain oversight functions…such that the functions have sufficient resources, status, authority and independence…”  S.10(2) The head of an oversight function of the credit union may be an individual employed by a third party to whom the credit union has outsourced that oversight function, so long as a member of the credit union’s senior management remains accountable for the performance of such individual and oversight functions and such an arrangement has been approved by, and is overseen by, the board of the credit union.  S.10(5): Individuals responsible for conducting activities of oversight functions shall be independent of the credit union’s and its subsidiaries operational activities and businesses  S.10(8): Heads of oversight functions shall be entitled to participate in all internal meetings, including those of senior management, of the credit union and its subsidiaries, on a reasonable basis, in order to reasonably monitor and assess the credit union’s and its subsidiaries activities” | **Questions/clarifications:**  Re: S.10(1): How do we interpret independence? Do oversight functions have independence if they report to the CEO? For example, CFO, CRO?  How do we put S10(5) into practice? For example, CFO and CRO are directly involved in business decision making to ensure the credit union is balancing meeting member needs, with financial stewardship and effectively managing and mitigating risks. How do we de-couple their roles from the operation? How would this serve to maintain a strong second line of defense?  Re: S.10(8): seems to suggest that heads of oversight functions-for example CRO and CFO are not considered senior management-is this the correct interpretation? Why is this section necessary? How is this not prescriptive? Who has the decision rights to determine what a “reasonable basis” is for attending “all internal meetings, including senior management meetings”? |
| **Item 5: Risk management function** | |
| **SBFP draft rule section** | **Questions & required clarifications** |
| **S.12(2):**  The head of the risk management function of the credit union shall be appointed by and report to the board of the credit union | **Questions/clarifications:**  Is it correct that the intent is for the board to have the final hiring/personnel decision making authority of the CRO and that the CRO is to have a functional reporting relationship to the board? If this is correct, how does the board avoid violating the prohibition in S.97(1) and (2) of the CUCPA? The CRO function has direct involvement in the day-to-day operations of the credit union -eg: loan underwriting and credit adjudication decisions (as only two of many examples). How does this align and support the concept of second line of defense which the CRO is a critical component of? Doesn’t this remove from the CEO’s responsibility the implementation and monitoring of prudent and effective risk management practices, policies, procedures, and controls? Under this rule what is the CEO’s responsibility in the area of risk management versus the board’s responsibility?  Why does this draft rule prescribe the CRO reporting to the board versus the head of internal audit whose function is independent of the operations of the credit union by design, and is a key component of the third line of defense? |
| **Item 6: Finance function** | |
| **SBFP draft rule section** | **Questions & required clarifications** |
| **S.14(1)(ii):**  Provide accurate, reasonable, independent, reliable and risk based financial reporting and analysis to senior management and the board of the credit union.  S.14(2): the head of the finance function shall:  (i) advise the CEO and board, including in relation to matters described in S.14(1) and  (ii) have reasonable knowledge of and opportunity to participate in all material functions of the credit union’s and its subsidiaries’ businesses and operations | **Questions/clarifications:**  Re: S.14(1)(ii): How do we interpret “independent” in this section? Are there criteria to define what is meant beyond the usual internal and external audit oversight?  Re: S.14(2): (i) what does advise the CEO and board mean? Advise on what matters beyond those described in S.14(1)? (ii) doesn’t this subsection contradict what is set out in S.10(5)? Where it states: “Individuals responsible for conducting activities of oversight functions shall be independent of the credit union’s and its subsidiaries operational activities and businesses”? |

**Other Comments:**

It may also be worth commenting on the **Anticipated Costs and Benefits** section of FSRA’s Notice of Rule:

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| **Stated Benefits** | **Questions / Comments** |
| *“... advancing FSRA’s cross-sectoral priority of transitioning to principles-based regulation”* | This rule seems very prescriptive and not principles based. The word “shall” appears more than 50 times in the body of the rule. |
| *“There are likely to be minimal qualitative costs associated with the Proposed Rule.”* | As you’ve noted above, this is a dramatic understatement and/or patently false. |
| *“... as a result of the principles-based framework and increased responsibility and accountability for credit union directors and managers, the Proposed Rule may necessitate the redistribution and reallocation of resources within credit unions.”* | If we are forced to create separate risk and finance functions, the costs will be material. There may also be increased costs at the board level as the scope of oversight responsibilities will materially increase. I think it’s also worth mentioning the risks of constructive dismissal of virtually every CEO in the system and resulting disruption and costs of hiring / re-hiring the CEO. |
| *“Well-run and mature credit unions are not expected to incur new material financial costs in order to ensure compliance with the Proposed Rule”* | As you’ve noted in your recent report to the board, we are FSRA’s poster-child for a “well-run and mature credit union” and yet we will likely incur materially increased costs and see no demonstrable benefits. If necessary, we may need to map out these costs to prove that this statement is false. |