



February 4, 2022

Financial Services Regulatory Authority of Ontario

Sent via email to: [Consultation on new Risk Based Supervisory Framework for Credit Unions | Financial Services Regulatory Authority of Ontario \(fsrao.ca\)](#)

Re: FSRA Consultation — New Risk Based Supervisory Framework for Credit Unions

Members of the Committee:

On behalf of The Institute of Internal Auditors (The IIA), we are writing to express our support for the Financial Services Regulatory Authority's (FSRA) new Risk Based Supervisory Framework (Framework). This important transformational shift will be helpful in generating important discussions between FSRA and Credit Unions (CU) regarding governance and can be expected to lead to better overall outcomes for the sector and CU members. The IIA acknowledges and supports the recognition of the importance of the Internal Audit function as an independent oversight function. Such recognition is consistent with other regulatory frameworks including both the Basel Committee on Banking Supervision which requires banks to have 'an internal audit function with sufficient authority, stature, independence, resources and access to the Board of Directors', and Canada's Federal regulator, the Office of the Superintendent of Financial Institutions (OSFI), which describes the important role of that Internal Audit provides to the Board of Directors (through the Audit Committee) and Senior Management of a federally-regulated financial institution in providing independent assurance of the effectiveness of, and adherence to, the institution's internal control, risk management and governance processes. In Ontario, we believe that there is a unique opportunity to leverage Internal Audit functions due to Bylaw #5 which reflects the important governance related roles played by the Board, Audit Committee, Risk Management and Internal Audit functions.

FSRA's new risk-based, governance-focused approach aligns well with the IIA's Three Lines model¹ which describes the important roles and relationships related to risk management and corporate governance. We have included an overview of the model in the attachment to this letter. The IIA's 2020 publication describes the three lines as follows:

1. *First line roles* are most directly aligned with the delivery of products and/or services to clients of the organization and include the roles of support functions.
2. *Second line roles* provide assistance with managing risk (these functions typically include areas such as compliance, cybersecurity, sustainability, etc.).
3. *Third line roles* provide independent and objective assurance and advice on the adequacy and effectiveness of governance and risk management.

Of interest, OSFI guidance also makes explicit reference to the IIA's Three Lines model (https://www.osfi-bsif.gc.ca/Eng/fi-if/rai-eri/sp-ps/Pages/12-Internal_Audit.aspx).

¹ *The IIA's Three Lines Model – An Update of the Three Lines of Defense*, published by The Institute of Internal Auditors, July 2020, <https://www.theiia.org/globalassets/documents/resources/the-iias-three-lines-model-an-update-of-the-three-lines-of-defense-july-2020/three-lines-model-updated.pdf>

As the chief advocate and standard-setting authority for the Internal Audit profession in Canada and with more than 4,000 members in Ontario, we are optimistic that The IIA is uniquely positioned to support the roll-out and long-term success of the new Framework. Some examples where The IIA might contribute include training for CU management/Internal Auditors/Risk Management professionals or Boards on the new Framework and FSRA's expectations, and practical guidance on how to effectively interact with FSRA. Through such collaborative efforts, the IIA and FSRA can work to promote transparency and clarity of expectations under the new Framework and support effective and efficient inspections.

With regards to the Framework document, we offer the following observations for your consideration:

Section 3.0, Oversight functions

There is an opportunity to clarify FSRA's references to independence in relation to an entity's internal oversight functions. The term independence is traditionally reserved for the Internal Audit function which ideally has a direct reporting relationship to the Board. Where the intention of the Framework is to address the level of cross-functional autonomy between oversight functions, alternative terminology may help to clarify intent. Similarly, references to independence in relation to Board reporting relationships might be clarified.

With reference to Internal Audit and Risk Management considerations noted in the Appendix to the Framework, we strongly recommend that FSRA consider 'evidence of compliance with IIA Standards' for Internal Audit and the results of Internal Audit/Independent assessment of the ERM function for Risk Management. Also, with regards to 'relationship' with other functions, we would like to highlight that a critical area of focus should be the inter-relationship between Risk Management and Internal Audit (e.g., Internal Audit's validation of key controls identified as mitigating activities for significant risks). For transparency and clarity, it would be helpful if FSRA could provide supplementary guidance on what specific criteria/considerations will be relevant for each of the 'essential elements' noted in Appendix D. As a comparison, OSFI provides such supplementary criteria for each Oversight Function.

The Framework references different delivery models for oversight functions, including outsourcing/co-sourcing of internal audit, risk management, etc. Appropriately, the Framework acknowledges that CU management maintains accountability for the function and ownership of risks, regardless of the delivery model. From a practical perspective, the wording of this section might be strengthened to clarify that outsourcing does not necessarily result in a 'gap' in oversight functions, but that such situations require due diligence by CU management to ensure effective risk management and control effectiveness. Clarity of roles, accountabilities and governance considerations for these types of relationships might be considered as a topic for further FSRA guidance.

Enterprise-Wide Oversight Ratings

We encourage FSRA to compare the results of its own enterprise-wide oversight assessment to any governance assessments self-initiated by the CU (whether conducted by Internal Audit or a third party). Where the results of the respective assessments significantly differ, this would be relevant information to communicate to CU management. Highlighting such differences would be valuable to better understand FSRA's expectations and to influence the scope and quality of future CU assessments.

Residual Risk (Section 4)

As noted above, the cross-functional relationship between Internal Audit and Risk Management is especially important in gauging corporate governance effectiveness. In particular, the extent to which Internal Audit and/or Risk Management have validated the effectiveness of key mitigating controls and activities for significant risks will help to ensure the reliability of reported residual risk.

We noted that the Framework references the expectation that the level of quality of controls and oversight be commensurate with the level of inherent risk, so the level of residual risk is considered 'prudent'; however, this reference appears somewhat vague and subjective. We would encourage FSRA to consider including reference to risk tolerance or risk appetite to further clarify expectations (e.g., are risks being effectively managed and mitigated in accordance with the CU's risk appetite). Further, as part of its Framework, FSRA might consider the adequacy of the process used CU management in establishing an appropriate risk appetite which best serves the interest of its members.

Risk Management Process (Updating risk assessments)

The new Framework conveys the onus on supervisors to monitor CUs for material changes in between full examinations. To foster transparency and accountability in the CU, we encourage FSRA to introduce a requirement for CUs to proactively report any material changes to FSRA on a timely basis. Introducing such a requirement would necessitate clear guidance on the nature of 'material' information/changes and the related communication timelines and protocols. Supplementary processes and activities by FSRA could serve to monitor for adherence to mandatory CU reporting requirements.

Reporting and Communicating to CUs

Consistent with expectations for the Internal Audit profession, we would encourage FSRA to standardize its inspection processes and templates. Consistency in the inspection process and content of Supervisory Letters will help to enhance the transparency and effectiveness of FSRA's processes. For example, standardization of the results validation process and requirement for exit meetings would help to foster better understanding of expectations by CU management and help to inform remediation plans. As currently drafted, the Framework appears to allow discretion for a meeting with CU senior management and directors to discuss findings and any issues of concern.

Under the Framework, FSRA may request that the CU's Internal Auditor, or at the CU's expense, its external auditor or another external resource (e.g., consulting firm) investigate and report on a matter to FSRA. For both practical and economical reasons, The IIA encourages FSRA to optimize use of Internal Audit in such situations. As an internal oversight function independent of management, Internal Audit is well positioned to respond to such requests in an effective and timely manner, as long as the subject matter at hand aligns with the skillset and expertise of the internal auditor. In situations where the External Auditor or other external party is to be engaged, sufficient notice and lead time will be necessary to ensure that FSRA's requirements can be addressed in the most effective, efficient and economical way. This approach appears consistent with FSRA's intention of minimizing regulatory burden and duplication of effort.



Risk Categorization Scale

The proposed risk categorization scale appears consistent with that used by OSFI and other provincial regulators. However, further details on how the scale will be applied and additional detail regarding the 'essential elements' referenced in Appendix D will be helpful to better understand the implications of the new framework from a practical perspective. We note that OSFI does provide further criteria related to each of the 'essential elements'.

Thank you for the opportunity to provide our comments on the proposed Risk Based Supervisory Framework for Credit Unions. As the standard-setting body for the practice of internal audit in Canada, we are supportive of FSRA's risk-based Framework and its approach to better serving the public interest. We look forward to an opportunity to engage with FSRA to explore how our organization and profession can support effective implementation and long-term success of the Framework.

If you have any questions regarding this letter or the IIA, please feel free to contact Paul Forgues at Paul.Forgues@theiia.org.

Yours sincerely,

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Attachment



The IIA's Three Lines Model

