XXVI Asamblea Anual de ASSAL

XVI Conferencia sobre Regulación y Supervisión de Seguros en América Latina IAIS-ASSAL

Programa

Hotel Sheraton San José, Costa Rica 13 al 16 de abril de 2015

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TORONTOCENTRE
Global Leadership in Financial Supervision

What is Corporate Governance?

- Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

OECD

What is Corporate Governance?

IAIS:

Corporate governance refers to systems (such as structures, policies and processes) through which an entity is managed and controlled. Accordingly, the corporate governance framework of an insurer:

- promotes the development, implementation and effective oversight of policies that clearly define and support the objectives of the insurer;

- defines the roles and responsibilities of persons accountable for the management and oversight of an insurer by clarifying who possesses legal duties and powers to act on behalf of the insurer and under which circumstances.

What is Corporate Governance?

- sets requirements relating to how decisions and actions are taken including documentation of significant or material decisions, along with their rationale;
- provides for communicating, as appropriate, matters relating to the management, conduct and oversight of the insurer to stakeholders; and
- provides for corrective actions to be taken for non-compliance or weak oversight, controls or management.

What is Corporate Governance?

Corporate governance refers to oversight mechanisms, including the processes, structures and information used for directing and overseeing the management of a company. It encompasses the means by which members of the board of directors and senior management are held accountable for their actions and for the establishment and implementation of oversight functions and processes.

OSFI – Canadian
Financial Regulator

Corporate Governance (CG) is particularly important for financial institutions (FIs)

The need for high standards of corporate governance, as well as the overall need for government supervision, is related to the enormous importance of financial institutions in every jurisdiction:

- FIs are making promises for future delivery of monetary services
- Mostly funded by members of the public with relatively small proportion of funds from shareholders
- Foreign investment is dependent on confidence in the financial system, which will not be maintained if institutions are not healthy
- Intermediation activities carried on by healthy, reliable FIs are the foundation of the entire economy.

CG is particularly important for financial institutions

FIs tend to be making promises about future performance.

For insurers this is especially noteworthy: non-performance by the insurer does not just lead to a loss of a premium.

It may lead to life-changing circumstances for the policyholder:

- A family loses its home to fire and the insurer does not pay.
- A husband with small children buys life insurance to look after his family in case he dies prematurely.
- A natural catastrophe strikes on region of a country.
- Life savings of insureds are invested in annuities

CG is particularly important for financial institutions

- Ordinary businesses are funded by knowledgeable shareholders and lenders who, under the requirements of securities laws, have supposedly been informed of the key risks to which they will be exposed.
- In the case of financial institutions, most of the financing comes from depositors and policyholders, who have virtually no knowledge of the financial activities of the FI with which they are placing funds.
- In addition, FIs tend to be highly levered, i.e. the shareholders provide only a small fraction of the required funding.

CG is particularly important for financial institutions

- Because of their role in financial intermediation, financial institutions play a central role in the economy.
- The failure of a large financial institution, or a number of smaller institutions, can lead to a loss of confidence in the financial markets, which in turn is likely to have a destabilizing effect on the entire economy.

CG is particularly important for financial institutions

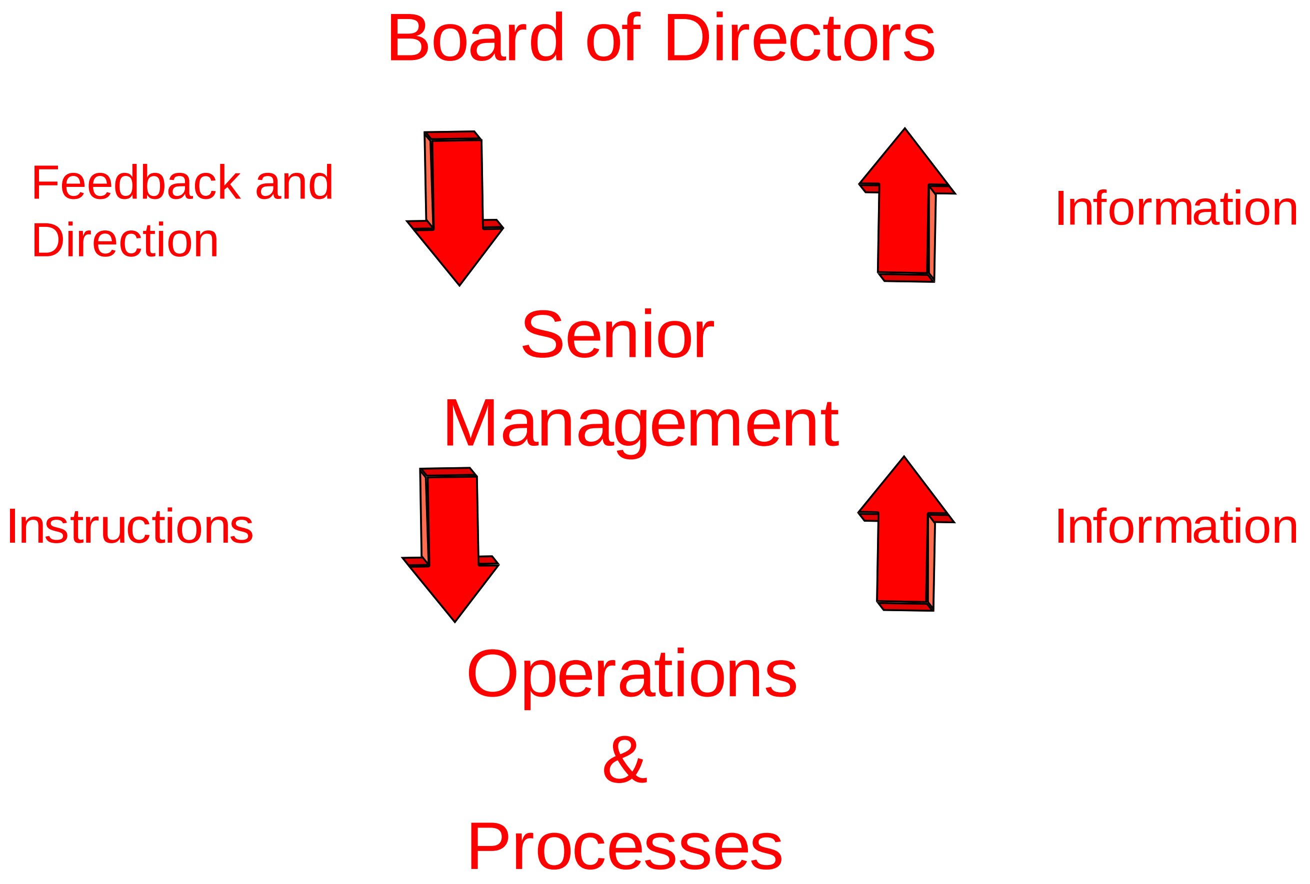
A final reason for the importance of good governance for financial institutions:

- Foreign investment is key to developing a vibrant and expanding economy.
- Confidence in the financial system is a prerequisite if the country is to attract foreign investors.
- Investors will not have confidence in the financial system if there are weak standards of corporate governance, because this will lead to higher rates of corporate failures and an atmosphere where there is a lack of trust in the institutions.

CG is particularly important for financial institutions

- Detailed disclosure of the type required by securities laws would generally not be of assistance to depositors and policyholders because they would not be in a position to evaluate the financial strength of the institution nor the riskiness of its business operations.
- For all of these reasons, it is universally agreed that banks and insurance companies must be subject to oversight by knowledgeable supervisory bodies that will be able to stand in the shoes of the public, acting on its behalf to see that the interests of public stakeholders are not overlooked.
- Corporate governance is the central theme of modern financial supervision.

Corporate Governance Feedback Loop



Role of the Board – Overview(1)

Direct:	the affairs of the company, establish appropriate policies and procedures for corporate governance and risk management
Protect:	the stakeholders, the company's financial position and assets
Connect:	with each other to form a collegial group for decision making
Expect:	appropriate governance and actions by management
Select:	the CEO
Correct:	the company's course when circumstances require
Inspect:	ensure that policies and procedures are adhered to.

(1) The Imperfect Board Member: Discovering the Seven Disciplines of Governance Excellence by Jim Brown.

International Standards in Corporate Governance and Risk Management (IAIS)

ICP 7 Corporate Governance

Overview – Corporate Governance

- The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.

ICP 7 Corporate Governance

7.1 Objectives and strategies of the insurer

Overview – Corporate Governance

- The supervisor requires the insurer's Board to set and oversee the implementation of the insurer's business objectives and strategies for achieving those objectives, including its risk strategy and risk appetite, in line with the insurer's long term interests and viability.

ICP 7 Corporate Governance

7.2 Appropriate allocation of oversight and management responsibilities

The supervisor requires the insurer's Board to:

- ensure that the roles and responsibilities allocated to the Board, Senior Management and Key Persons in Control Functions are clearly defined so as to promote an appropriate separation of the oversight function from the management responsibilities;
- and provide adequate oversight of the Senior Management.

ICP 7 Corporate Governance

7.3 The supervisor requires the insurer’s Board to have, on an on-going basis:

- an appropriate number and mix of individuals to ensure that there is an overall adequate level of knowledge, skills and expertise at the Board level commensurate with the governance structure and the nature, scale and complexity of the insurer’s business;
- appropriate internal governance practices and procedures to support the work of the Board in a manner that promotes the efficient, objective and independent judgment and decision making by the Board;
- and adequate powers and resources to be able to discharge its duties fully and effectively.

ICP 7 Corporate Governance

7.4 The supervisor requires the individual members of the Board to:

- act in good faith, honestly and reasonably;
- exercise due care and diligence;
- act in the best interests of the insurer and policyholders, putting those interests of the insurer and policyholders ahead of his/her own interests;
- exercise independent judgment and objectivity in his/her decision making, taking due account of the interests of the insurer and policyholders; and
- not use his/her position to gain undue personal advantage or cause any detriment to the insurer.

ICP 7 Corporate Governance

7.5 The supervisor requires the insurer's Board to provide oversight in respect of the design and implementation of sound risk management and internal control systems and functions.

7.6 The supervisor requires the insurer's Board to:

- adopt and oversee the effective implementation of a remuneration policy, which does not induce excessive or inappropriate risk taking, is in line with the identified risk appetite and long term interests of the insurer, and has proper regard to the interests of its stakeholders; and
- ensure that such a remuneration policy, at a minimum, covers those individuals who are members of the Board, Senior Management, Key Persons in Control Functions and other employees whose actions may have a material impact on the risk exposure of the insurer.

ICP 7 Corporate Governance

7.7 The supervisor requires the insurer's Board to ensure there is a reliable financial reporting process for both public and supervisory purposes which is supported by clearly defined roles and responsibilities of the Board, Senior Management and the external auditor.

7.8 The supervisor requires the insurer's Board to have systems and controls to ensure the promotion of appropriate, timely and effective communications with the supervisor and relevant stakeholders on the governance of the insurer.

ICP 7 Corporate Governance

7.9 The supervisor requires the insurer's Board to have appropriate policies and procedures to ensure that Senior Management:

- carries out the day-to-day operations of the insurer effectively and in accordance with the insurer's strategies, policies and procedures;
- promotes a culture of sound risk management, compliance and fair treatment of customers;
- provides the Board adequate and timely information to enable the Board to carry out its duties and functions including the monitoring and review of the performance and risk exposures of the insurer, and the performance of Senior Management; and
- provides to the relevant stakeholders and the supervisor the information required to satisfy the legal and other obligations applicable to the insurer or Senior Management.

ICP 7 Corporate Governance

7.10 The supervisor has the power to require the insurer to demonstrate the adequacy and effectiveness of its corporate governance framework.

ICP 8 Risk Management

Overview – Risk Management and Internal Controls

- The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.

ICP 8 Risk Management

8.1 The supervisor requires the insurer to establish, and operate within, effective systems of risk management and internal controls.

8.2 The supervisor requires the insurer to have effective control functions with the necessary authority, independence, and resources.

8.3 The supervisor requires the insurer to have an effective risk management function capable of assisting the insurer to identify, assess, monitor, manage and report on its key risks in a timely way.

ICP 8 Risk Management

8.4 The supervisor requires the insurer to have an effective compliance function capable of assisting the insurer to meet its legal and regulatory obligations and promote and sustain a corporate culture of compliance and integrity.

8.5 The supervisor requires that there is an effective actuarial function capable of evaluating and providing advice to the insurer regarding, at a minimum, technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements.

ICP 8 Risk Management

8.6 The supervisor requires the insurer to have an effective internal audit function capable of providing the Board with independent assurance in respect of the insurer's governance, including its risk management and internal controls.

8.7 The supervisor requires the insurer to retain at least the same degree of oversight of, and accountability for, any outsourced material activity or function (such as a control function) as applies to non-outsourced activities or functions.

Governance – A Structure:
Key Risk Management Control Functions

- Board
- Senior Management
- Risk Management
- Internal Audit
- Actuarial
- Compliance
- Financial

Risk Management Control Functions

Board of Directors

- Responsible for stewardship and management oversight
- Key responsibilities include:
  - ensure management is qualified and competent
  - review and approve organizational and procedural controls
  - ensure principal risks are identified and appropriately managed
  - review and approve corporate risk policy

Risk Management Control Functions

Board of Directors

- Key responsibilities include (cont'd):
  - review and approve policies/procedures for major activities
  - review and approve strategic and business plans
  - provide for an independent assessment of management controls
  - ensure compensation for employees, senior management and Board is aligned with the long-term interests of FRFI

Risk Management Control Functions

Senior Management

- Responsible for planning, directing and controlling the strategic direction and general operations of the institution
- Key responsibilities include:
  - ensure organizational and procedural controls are effective
  - ensure compliance with policies/procedures
  - develop strategies/plans to achieve business objectives
  - develop sound business practices, culture and ethics
  - develop and promote (in conjunction with Board) sound corporate governance practices, including aligning employee compensation with long-term interests of FRFI
  - ensure that Board is kept well informed

Role of Independent Directors

- An independent director is a director who is not a member of management, or a significant shareholder, or affiliated with a significant shareholder.

- Modern corporate law (and certainly insurance laws that are consistent with international standards) require the board to have at least some independent members. The purpose is to ensure a degree of objectivity in the board's decision making.

- In many countries the law now requires that from 1/3 to a majority of directors be independent.

Role of Independent Directors

- Independent directors, in fact all directors have a responsibility to consider the interests of all stakeholders, including minority shareholders and policyholders, to make sure that the majority shareholder is not taking advantage of its position at the expense of the other stakeholders.

Corporate Governance and insurance supervision

The weaknesses demonstrated by many corporate failures are hoped to be checked by systems of Corporate Governance having the following characteristics:

- Substantial proportion of independent directors, some of whom are knowledgeable about insurance/finance.
- Important board committees, e.g. risk and audit, have majority of independent directors.
- Meaningful input of full board in formulation of business strategy, risk management processes and all key business functions.
- Board approved, clearly defined and closely monitored “risk appetites” for all critical risk areas.
- Every institution to have expertise in risk management.

Corporate Governance and insurance supervision

When supervisory agencies focus on strengthening corporate governance they are in effect assisting supervised institutions to improve their management structures and overall financial performance.

Question:

- Independent directors at the expense of technical ability and industry skills ? Does there have to be a trade off ?

Corporate Governance is in the Public Interest

- OSFI expects that directors and senior management will take the interests of depositors, policyholders and other creditors into account in fulfilling their responsibilities.

- OSFI uses its supervisory relationship with the institution (e.g., through its discussions with the board and management) to reinforce this expectation when necessary.

OSFI – Canadian Financial Regulator

Defining the Risk Appetite

Looking back at the Canadian situation during the 1980s, when there were numerous insurance company failures, it was typical for board members to say things like

- *Reinsurance? How would we know there was a problem with the reinsurance? We are not experts in that technical subject.*
- *So the company invested too much of its funds in real estate. Well don't blame the directors. We are not experts in, nor do we monitor day-to-day liquidity requirements.*
- *As board members we were not aware that the company had an excessive credit risk exposure as a result of lending funds to one of its major brokerage providers.*

Defining the Risk Appetite

- It is true that we can't expect board members to be experts in all fields.
- However, we can expect them to provide senior managers with a framework for risk taking, so that the people making day-to-day decisions are doing so within a framework that has been carefully thought out and clearly stated.
- For example, in the field of reinsurance, they can obtain whatever advice they need to establish some major parameters . . .

Defining the Risk Appetite

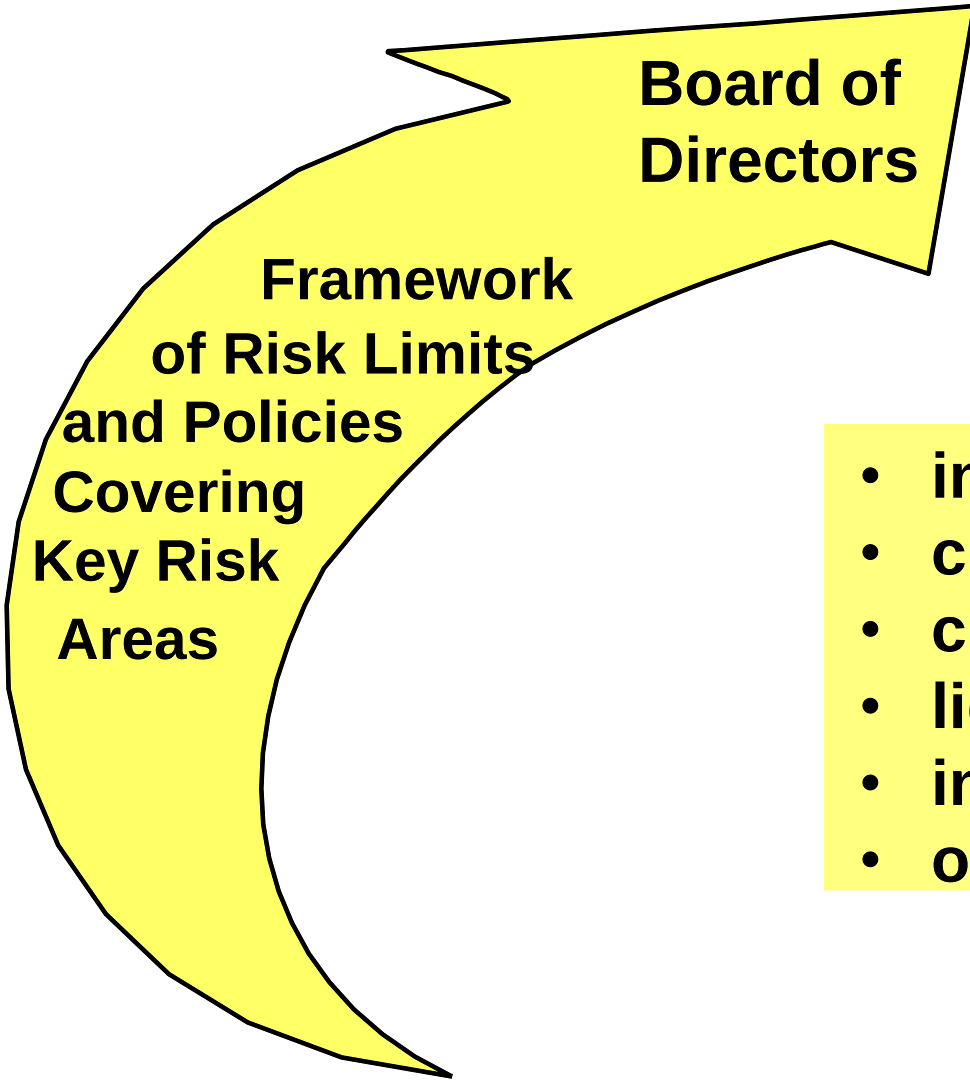
- What is the maximum net exposure and gross exposure we are prepared to assume for any one loss?
- What is the maximum net exposure we are prepared to assume for any one event?
- What is the minimum credit rating we should consider acceptable for each reinsurer we use?
- What is the minimum number of reinsurers over which we will spread our business?

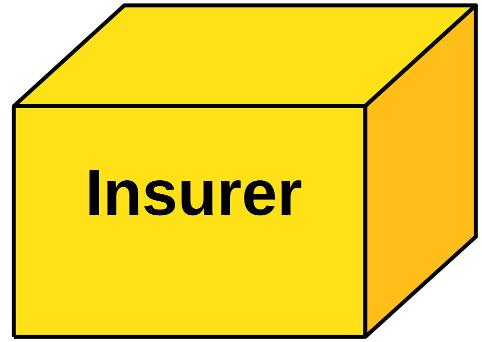
Any one of these points that could “make or break” the company, depending on the circumstances.

Defining the Risk Appetite

- It is not appropriate for the board to leave all of these decisions to the staff in the reinsurance department or even a VP of Reinsurance.
- Even if that person is highly competent, he or she will not be aware of the other risk decisions that are being made for other risk areas.
- For example, a company may wish to take on more market risk but to do so will want to ensure that credit risk and liquidity risk are both minimized.
- Staff at the operational level would have no idea of how their particular area might be affected by such required balancing. So in the absence of a framework that is being devised and monitored at the board level, risks can accumulate without being noticed.

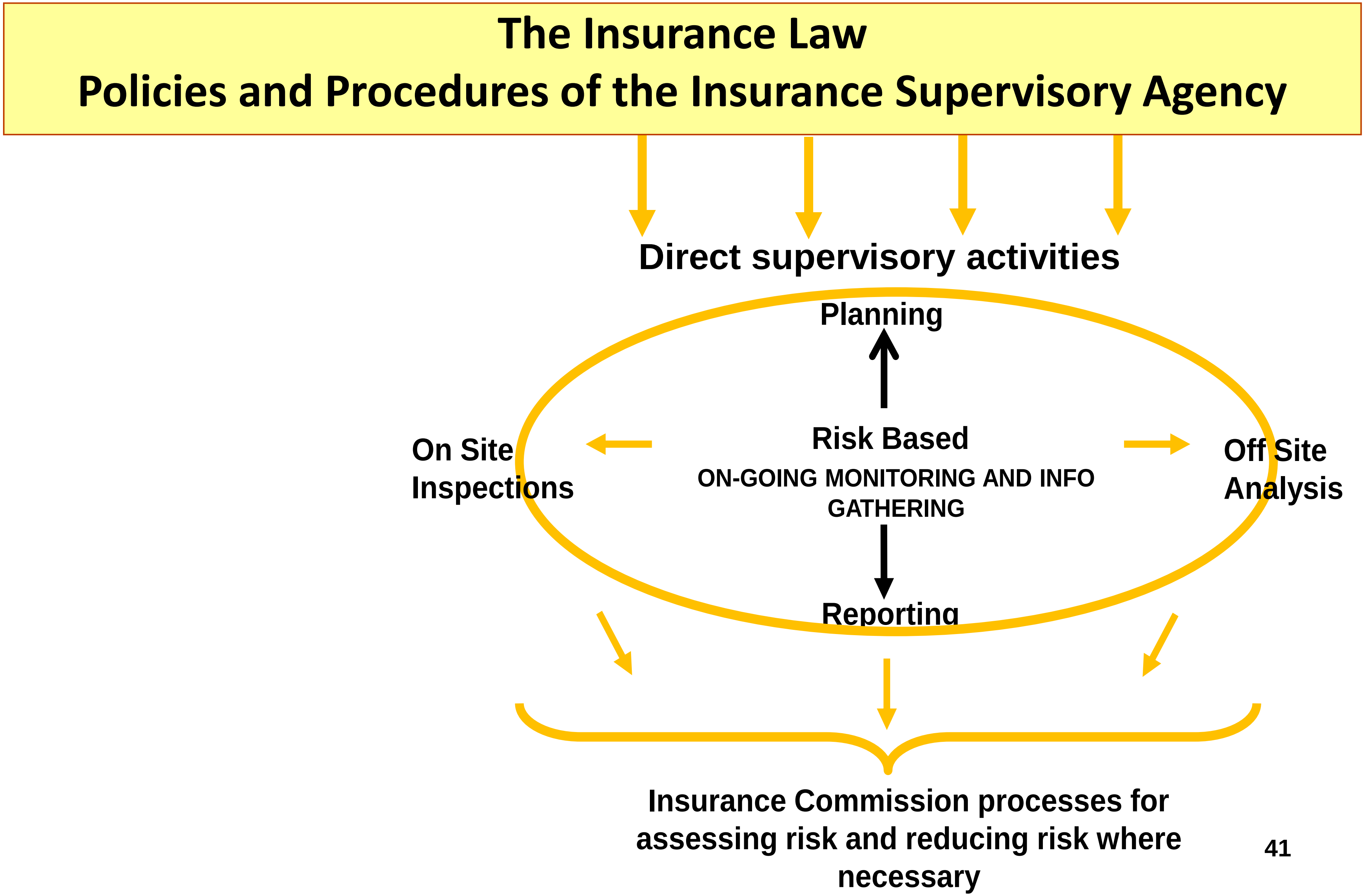
Insurers Define Risk Appetite for Key Risk Areas



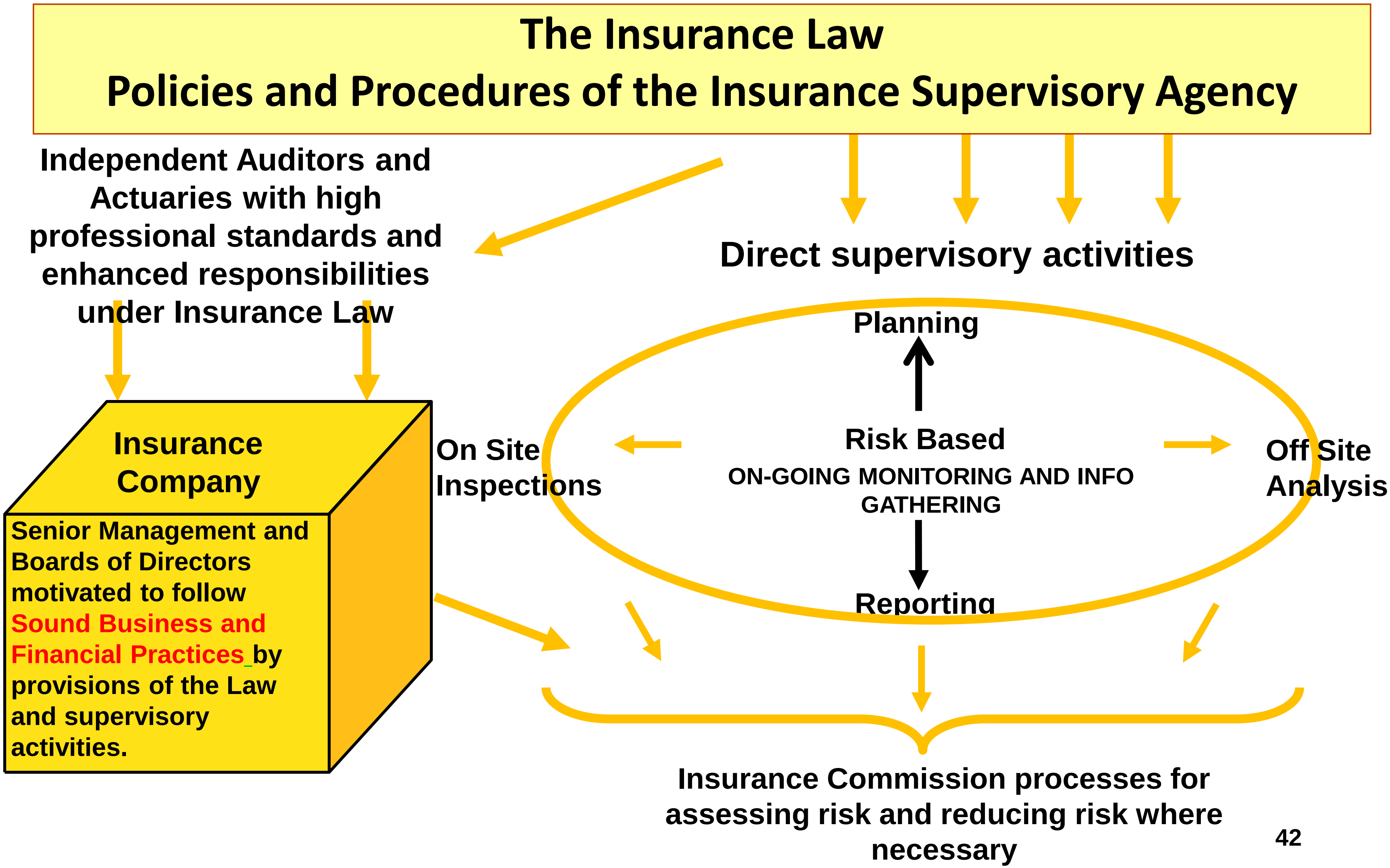


- insurance risk
- credit risk
- claim management risk
- liquidity risk
- investment risk
- operational risk

A Modern Supervisory Framework



A Modern Supervisory Framework



A Modern Supervisory Framework

- As we see, key principles of corporate governance can be enshrined in the law with additional detail by means of regulatory guidelines.

However . . .

- “No law can prevent bad judgement or stop all criminal acts. In the public and private sectors alike, the ability to earn trust depends utterly on the moral compass of those at the helm. Good governance, in the end, is not a set of rules but rather an expression of values.”[1.]

1. “GOVERNANCE, VALUES AND COMPETITIVENESS”, A Study by the Canadian Council of CEO’s

A Modern Supervisory Framework

Traditional Approach to Supervision	Modern Approach to Supervision
Many detailed rules constrain company options	Less detailed, less intrusive, more principle based
Supervisor's objective is to find financial problems	Supervisor's objective is to <u>avoid</u> financial problems
Supervisor must ensure compliance	Company (Board, Manage-ment, Auditor) mainly responsible for compliance
Supervisory responses difficult to predict, sometimes not consistent	Transparent processes: risk assessment and expected supervisory responses based on established framework

Corporate Governance and Risk Management

Corporate governance consists of the processes, structures, information, and relationships used for directing and overseeing the management of the institution in the best interest of the institution and the key stakeholders that have a significant interest in the ongoing viability of the company.

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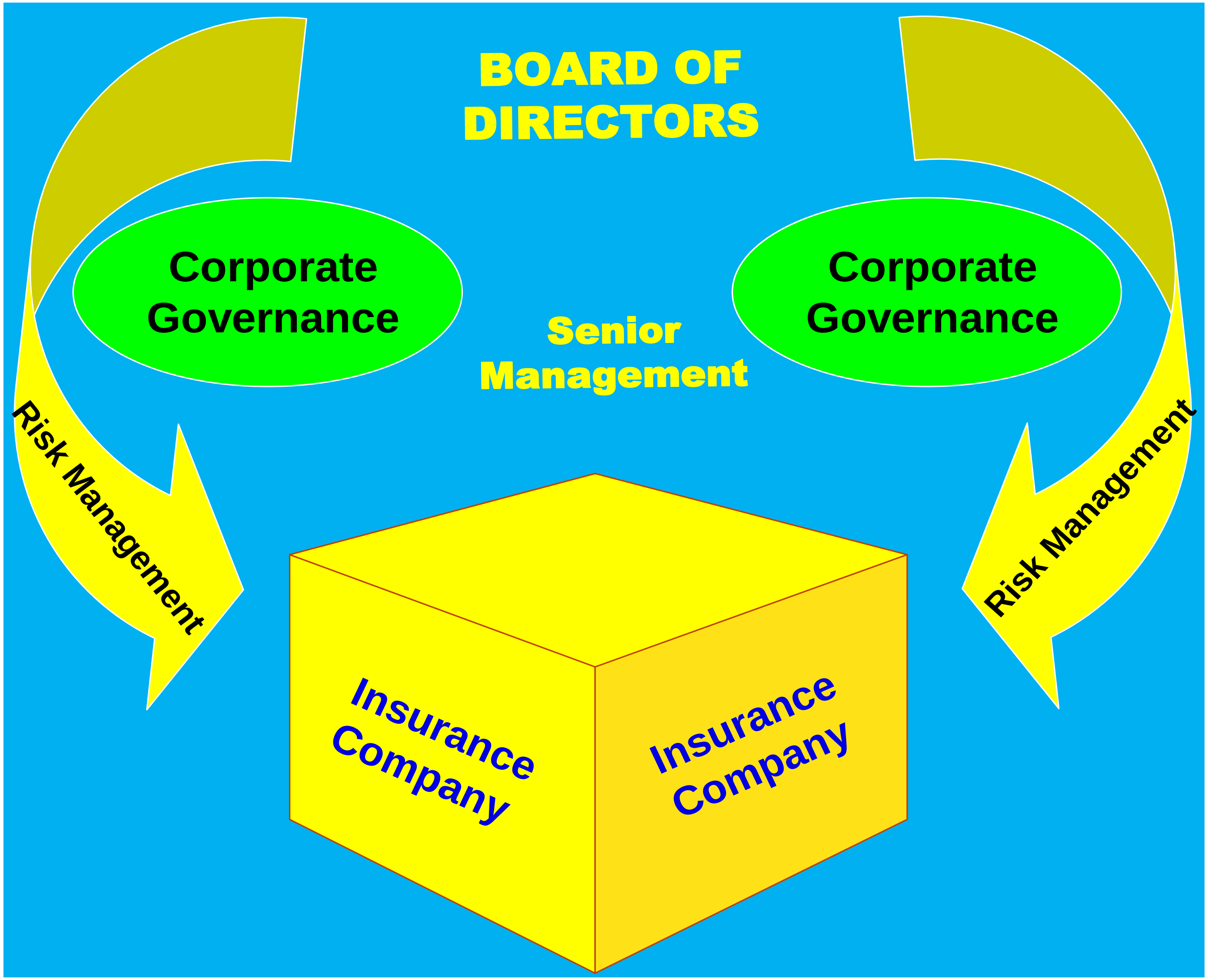
World Bank

Risk Management consists of the systematic application of management policies, procedures and practices to the tasks of identifying, analysing, evaluating, treating and monitoring risk.

Corporate Governance and Risk Management



"Stronger Corporate Governance and Its Implications on Risk Management" Anne E. Kleffner, Ryan B. Lee and Bill McGannon, Ivey Business Journal, May/June 2003

How Can Financial Supervisor Improve the Effectiveness of Corporate Governance?

Corporate governance is a historically grown set of lessons learned from experience

- Weak and ineffective corporate governance is systemically important financial institutions was an important contributing factor to the economic crisis that began in 2007
  - Many banks have successfully tackled the challenge and improved their governance - mostly on their own - sometimes with guidance from their supervisors

Regulators and supervisors are important stakeholders in financial markets

*A Global Corporate Governance Forum Publication, IFC

How Can Financial Supervisor Improve the Effectiveness of Corporate Governance?

- Focus on corporate governance - in the pre Global Financial Crisis era - was primarily on the characteristics of governance
  - Observable
  - Measurable

- Governance of financial institutions was not sufficient to prevent the behavioural excesses that contributed to the crisis, why
  - Were members unqualified?
  - Were boards poorly structured?
  - Did boards have the wrong mandates?

*A Global Corporate Governance Forum Publication, IFC

How Can Financial Supervisor Improve the Effectiveness of Corporate Governance?

Or

- Did boards fail to challenge management - become cheerleaders for unlimited liquidity, low interest rates, perpetual growth, growing profits and stock option benefits?

*A Global Corporate Governance Forum Publication, IFC

How Can Financial Supervisor Improve the Effectiveness of Corporate Governance?

- The responsibilities of the board of a financial institution are often more onerous that those of boards of other types of enterprises
- Financial institutions are licensed by the state to take money from the public
    - Take deposits
    - Manage investments
    - Issue insurance policies

*A Global Corporate Governance Forum Publication, IFC

How Can Financial Supervisor Improve the Effectiveness of Corporate Governance?

- Boards have both explicit and implicit obligations to safeguard such monies and ensure that they remain available for the purpose for which they were entrusted
    - Responsibility
        - to ensure that financial firms are managed in a safe and sound manner
        - To be in compliance with relevant legislation, regulations, and guidelines

*A Global Corporate Governance Forum Publication, IFC

How Can Financial Supervisor Improve the Effectiveness of Corporate Governance?

Existing Supervisory Guidelines - what does the Supervisor focus on:

- Characteristics?
- Performance?

- Are these all characteristics?
  - Board reviews of policies and procedures regarding controls
  - Composition of board, and committees

*A Global Corporate Governance Forum Publication, IFC

How Can Financial Supervisor Improve the Effectiveness of Corporate Governance?

- Are these all characteristics (cont…)?
  - Are there committees ? - audit, risk, investment
  - Mandates
  - Are board members independent? How many?
  - Frequency of board meetings
  - Appointment process for board members
  - Etc
- Do these really show anything - do they help in evaluating a bank's corporate governance policies and practices (performance) ?

*A Global Corporate Governance Forum Publication, IFC

Five Suggestions*

- Review agendas and supporting material for meetings of the board and board committees
  - Do the agendas address key risk areas - is there time for discussion/challenges
  - Is supporting material sufficient to provide context and detail to board members

*A Global Corporate Governance Forum Publication, IFC

Five Suggestions*

- Focus on what actually takes place in meetings of the board and board committees
  - Review minutes - is there wide participation, is there evidence of challenges (with follow-up, requests for further information, updates)
  - Are there refusals to accept management recommendations, or granting of approvals with conditions
  - Are requests by the board followed-up in subsequent board meetings
  - Hold periodic meetings with individual board members - seek information on how the board and its committees carry out their work and exercise their challenge function
  - Attend board meetings

*A Global Corporate Governance Forum Publication, IFC

Five Suggestions*

- Active program of onsite supervision
  - Much supervisory work is carried on offsite (often this is the default strategy)
    - This strategy - alone - is not effective
  - For governance oversight
    - offsite supervision cannot be effective
    - encouraging a tick-box approach -
    - verifying characteristics but ignoring performance assessment

*A Global Corporate Governance Forum Publication, IFC

Five Suggestions*

- Onsite supervision - promotes the development of sufficient knowledge of the financial institution and its business practices - to be able to understand the major risks and vulnerabilities
  - Lack of understanding of the institution and its risks - will not allow the supervisor to assess the effectiveness of the governance process in controlling such risks

*A Global Corporate Governance Forum Publication, IFC

Five Suggestions*

- Develop a good understanding of the key risks and controls that supervisors require the board to oversee
  - To be able to rely on the board to provide effective oversight of the key risks - as well as the controls over those risks - supervisors must have a good understanding of those risks and controls
    - This requires sufficient onsite supervisory activities, and
    - Involvement of technical risk specialists (ideally as members of their staff)

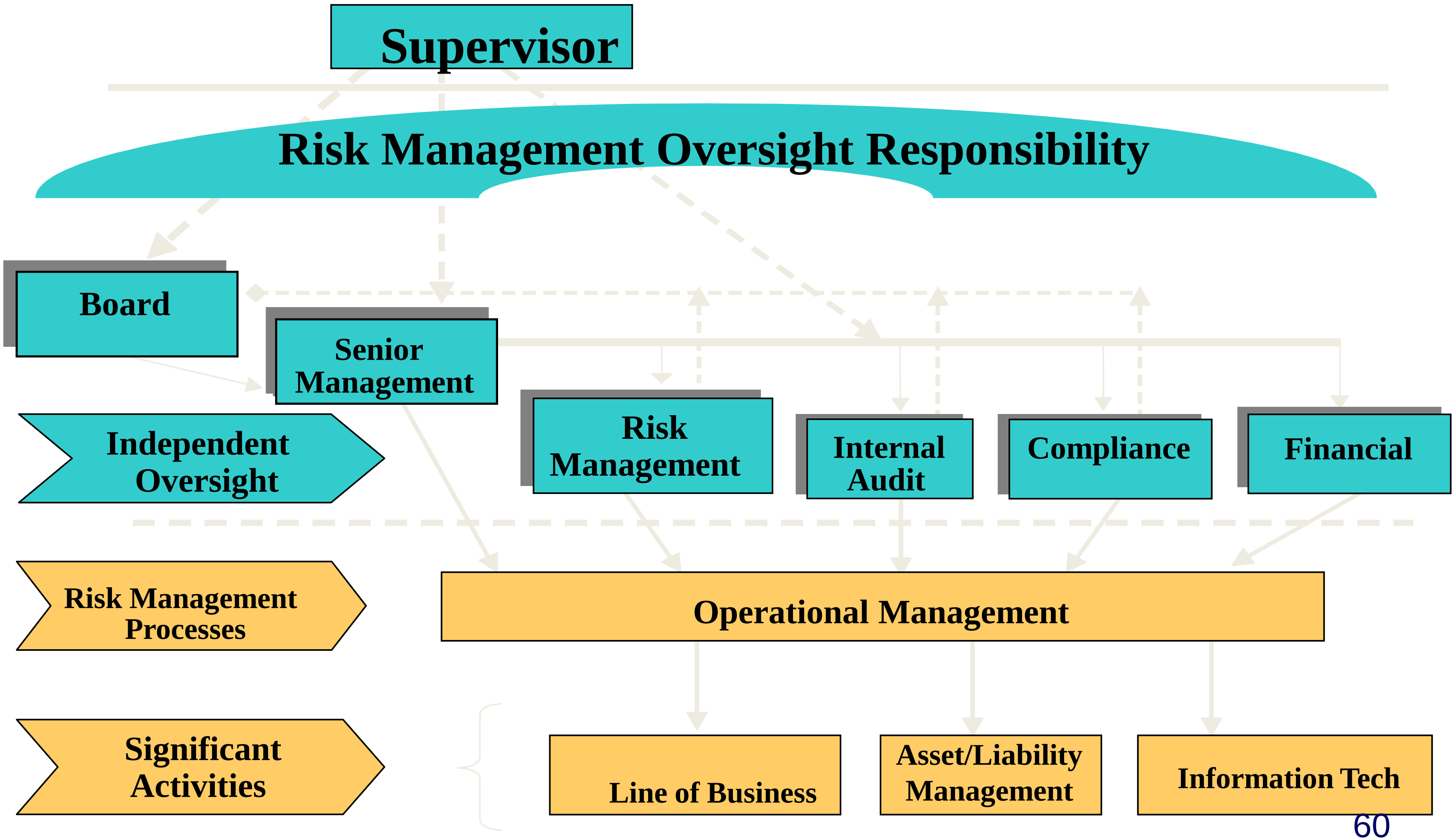
*A Global Corporate Governance Forum Publication, IFC

Five Suggestions*

- Engage the board and key committees proactively and regularly
  - Regular meetings with board/committees (e.g. risk/audit) to report of supervisory findings and to seek board engagement
  - Provides an opportunity to ensure that board members understand the supervisors' main concerns - and of the supervisors' expectations of the board
  - Meetings provide corroborative evidence of the quality of board performance

*A Global Corporate Governance Forum Publication, IFC

An Approach to Assessing Governance Effectiveness
Risk Management Control Hierarchy



Key Risk Management Control Functions

- Board
- Senior Management
- Risk Management
- Internal Audit
- Actuarial
- Compliance
- Financial

Risk Management Control Functions

Board of Directors

- Responsible for stewardship and management oversight
- Key responsibilities include:
  - ensure management is qualified and competent
  - review and approve organizational and procedural controls
  - ensure principal risks are identified and appropriately managed
  - review and approve corporate risk policy

Risk Management Control Functions

Board of Directors

- Key responsibilities include (cont'd):
  - review and approve policies/procedures for major activities
  - review and approve strategic and business plans
  - provide for an independent assessment of management controls
  - ensure compensation for employees, senior management and Board is aligned with the long-term interests of FRFI

Risk Management Control Functions

Senior Management

- Responsible for planning, directing and controlling the strategic direction and general operations of the institution
- Key responsibilities include:
  - ensure organizational and procedural controls are effective
  - ensure compliance with policies/procedures
  - develop strategies/plans to achieve business objectives
  - develop sound business practices, culture and ethics
  - develop and promote (in conjunction with Board) sound corporate governance practices, including aligning employee compensation with long-term interests of FRFI
  - ensure that Board is kept well informed

Risk Management Control Functions

Risk Management

- Independent function responsible for planning, directing and controlling impact of risks arising from operations
- Generally only found as a separate unit in larger institutions
- May address:
  - identification of risks
  - development of risk measurement systems
  - development of risk tolerance limits
  - establishment of policies/procedures to manage risk

Risk Management Control Functions

Internal Audit

- Independent function that assesses adherence to and effectiveness of operational and organizational controls
- May also assess adherence to and effectiveness of compliance and risk management policies/procedures

Risk Management Control Functions

Actuarial

- Independent function responsible for overseeing key risks in insurance companies – Duties could include:
- evaluating the design, pricing and valuation of the insurance products offered by co.
- assessing reasonableness of provisions set for policy liabilities and appropriateness of the process followed
- reviewing models used to determine exposures and the adequacy of reinsurance programs
- analyzing stress testing results and process used to establish adequacy of capital and capital planning for FRFI under adverse conditions
- reporting on results to Senior Mgmt and Board

Risk Management Control Functions

Compliance

- Independent function that:
  - Sets policies/procedures for adherence to regulatory requirements in all jurisdictions FRFI operates
  - Monitors institution’s compliance with these policies/procedures
  - Reports on compliance matters to senior management and the Board
  - Includes chief anti-money laundering officer (CAMLO)

Risk Management Control Functions

Financial

- Independent function responsible for ensuring timely and accurate reporting & in-depth analysis of the operational results of FI to support decision-making by Senior Management and the Board. Duties include:
- providing financial analysis of FI's and business line/unit performance and major business cases to Senior Management and the Board, highlighting matters requiring their attention
- ensuring an effective financial reporting and management information system
- Generally only found as a separate unit in larger FIs
- Effective reporting key to this function, as operational results affect strategic and business decisions

Key Attributes of Risk Management Control Functions

Independence

- no operational responsibilities
- reports to CEO/Board
- free from influence

- Separate organizational unit
- Oversight Power and Authority
- Direct link to Senior Management and Board

Why assess the Risk Management Control Functions?

- To determine if we can use their work and how much (supervisory leverage)
- To use their work as a “window” into the control environment of the institution
- To determine if we can reduce the scope of our supervisory work over operational controls (leverage)
- If weaknesses detected – provides support for intervention activities

What If We Can't Rely on the Risk Management Control Functions?

- Look for compensating controls.
- Take alternate steps:
  - requiring expanded External Auditor work
  - expanding our supervisory work on-site
  - make appropriate recommendations or direct that appropriate work be done

Assessing Risk Management Control Functions

- Two Tracks to the assessment:
  - review by Significant Activity – left to right review (Track 1)
  - top down review – predictive, diagnostic (Track 2)
- Characteristics vs. Performance
  - …Challenge: determining effectiveness
- Documenting the assessment

Track 1 – Assess Risk Management by Significant Activity

RISK MATRIX									
		Inherent Risks		Quality of Risk Management					
Significant Activities	Materiality	Credit	Market, Insurance, Strategic, etc.	Operational Management	Compliance	Internal Audit	Risk Mgt., Sr. Mgt., Board	Net Risk	Direction of Risk
#1									
#2									
#3									
								Overall Net Risk	

Inherent Risks mitigated by Operational Management overseen by Risk Management Control Functions results in Net Risk by Significant Activities

Weighted Net Risk by Significant Activities results in Overall Net Risk

Capital		Earnings		Liquidity	
Composite Rating		Direction of Risk		Time Frame	

Track 2 – Assess Risk Management Overall

RISK MATRIX									
		Inherent Risks		Quality of Risk Management					
Significant Activities	Materiality	Credit	Market, Insurance, Strategic, etc.	Oper. Management	Compliance	Internal Audit	Risk Mgt., Sr. Mgt., Board	Net Risk	Direction of Risk
#1						Eff.			
#2						Eff.			
#3						Eff.			
					Overall Eff.	Overall Eff.	Overall Eff.		

Characteristics combined with performance results in a Risk Management Control Function "Effectiveness" rating by Significant Activity, and the Risk Management Control Function overall

Capital		Earnings		Liquidity	
Composite Rating		Direction of Risk		Time Frame	

Assessing Risk Management Control Functions

- Supervisory Assessment Guides
- Characteristics
  - Essential Elements, i.e. organization, mandate, resources, methodology/policies, reporting process, relationship with Senior Management and Board
- Performance
  - How well the Risk Management Control Function fulfills its mandate

- Characteristics + Performance = Effectiveness

OSFI's Supervisory Assessment Guides

- Criteria to assist supervisors in developing a rating. They will help in:
    - developing a structural overview of a Risk Management Control Function
    - identifying the cause(s) of why a Risk Management Control Function is ineffective in a particular Significant Activity

OSFI's Supervisory Assessment Guides

- The criteria are to be used as a reference guide, not a checklist
- Supervisors are expected to determine how an institution addresses the essential elements
- Performance is key in arriving at an assessment
- Risk Management Control Function assessments must be documented and defensible based on the results of significant activity reviews

Supervisory Assessment Guides - Example

Internal Audit – Essential Elements/Criteria

- Role
- Ratings Quality
- Mandate
- Organization Structure
- Resources
- Methodology and Practices
- Planning
- Reporting
- Quality Assurance
- Senior Management and Board Oversight

Supervisory Assessment Guides - Example

- Internal Audit – Essential Elements/Criteria

- Role of Internal Audit
  - provide independent oversight of effectiveness of and adherence to institution's organizational and procedural controls
  - may also oversee effectiveness of and adherence to the institution's compliance and risk management policies/procedures

Track 2 – Overall Assessment

INSTITUTION NAME

RISK MATRIX as at DATE

Review of the characteristics of the risk management functions

Significant Activities	Materiality	Inherent Risks: Credit	Inherent Risks: Market, Insurance, Strategic etc.	Quality of Risk Management: Operational Management	Quality of Risk Management: Compliance	Quality of Risk Management: Internal Audit	Quality of Risk Management: Risk Mgt., Snr. Mgt., Board	Net Risk	Direction of Risk
#1									
#2									
#3									
						Overall Rating			

Review of Significant Activities (including Effectiveness of risk management functions)

Ratings:
Strong
Acceptable
Needs Improvement
Weak

Capital (S/A/NI/W)		**Earnings** (S/A/NI/W)		**Liquidity**	
Composite Rating		**Direction of Risk**		**Time Frame**	

Why Assess Risk Management Control Functions?

- Identify areas where risk management is weak
- Leverage off these functions in well managed areas
- Reduce supervisory work
- Focus supervisory resources in higher risk areas

Thank you

Program Funded by:

Foreign Affairs, Trade and Development Canada
Affaires étrangères, Commerce et Développement Canada

International Monetary Fund

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