



**Canada Deposit Insurance
Corporation**

Special Examination Report—2010



Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

Ce document est également publié en français.





Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

To the Board of Directors of
Canada Deposit Insurance Corporation

We have completed the special examination of the Canada Deposit Insurance Corporation in accordance with the plan presented to the Audit Committee of the Board of Directors on 10 February 2009 as well as the addendum to the plan presented on 20 May 2009. As required by Section 139 of the *Financial Administration Act*, we are pleased to provide the attached final special examination report to the Board of Directors.

We will be pleased to respond to any comments or questions you may have concerning our report at your meeting on 3 March 2010.

I would like to take this opportunity to express my appreciation to the Board members, management and the Corporation's staff for the excellent co-operation and assistance offered to us during the examination.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Clyde M. MacLellan".

Clyde M. MacLellan, CA
Assistant Auditor General

Attach

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Canada Deposit Insurance Corporation

Special Examination Report—2010

Main Points

What we examined

Canada Deposit Insurance Corporation (CDIC) is a federal Crown corporation with a mandate to insure savings deposited in a CDIC member institution against loss in the event that the institution fails. The Corporation is also to promote and otherwise contribute to the stability of the financial system in Canada. The Corporation reports to Parliament through the Minister of Finance.

CDIC was established in 1967 under the *Canada Deposit Insurance Corporation Act*. Its head office is located in Ottawa, and there is one office in Toronto. At 31 March 2009, the Corporation had 97 permanent employees.

We examined whether CDIC's systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. Our examination covered the systems and practices in place between February 2009 and June 2009, including those in the areas of corporate governance, strategic direction and risk management, intervention and risk assessment, and human resources.

Why it's important

The federal oversight and safety net system for deposit-taking institutions are essential to the stability of the Canadian financial system. The overwhelming majority of Canadians and Canadian businesses have deposits that are insured by CDIC, whose primary role is to protect these depositors—in the event of a member institution failure. Canadians expect CDIC to be able to fulfill this role.

What we found

We found no significant deficiencies in the Corporation's systems and practices. In the areas where we focused our examination, we noted a number of good systems and practices. Some examples are outlined below.

- CDIC has the key elements of a good governance framework and its governance practices are consistent with best-practice expectations for stewardship by boards of directors. In addition, its systems and practices for human resources management provide

the Corporation with the core competencies and skills it needs to meet its objectives.

- The Corporation identifies and monitors risk and reports on its risk assessment to the Board's Audit Committee each year. It also carries out ongoing risk assessment of its member institutions, which enables it to keep track of developments affecting them and the financial services sector in general. Since our previous special examination in 2004, it has improved its readiness to intervene in the affairs of a troubled member.
- CDIC has a sound strategic planning process. It could, though, improve its reporting on performance by including in its corporate scorecard not only the planned key initiatives and key performance indicators currently presented but also an indication of its progress toward meeting its stated intended outcomes.

***The Corporation has responded.** The Corporation agrees with our recommendation. Its response follows the recommendation in the report.*

Special Examination Opinion

To the Board of Directors of Canada Deposit Insurance Corporation

1. Under section 131 of the *Financial Administration Act* (FAA), the Canada Deposit Insurance Corporation is required to maintain financial and management control and information systems and management practices that provide reasonable assurance that its assets are safeguarded and controlled; its financial, human, and physical resources are managed economically and efficiently; and its operations are carried out effectively.
2. Section 138 of the FAA also requires the Corporation to have a special examination of these systems and practices carried out at least once every ten years.
3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination—from February 2009 to June 2009—there were no significant deficiencies in the Corporation’s systems and practices.
4. We based our examination plan on our survey of the Corporation’s systems and practices and a risk analysis. On 2 February 2009 we submitted the plan to the Audit Committee of the Board of Directors. We also presented an addendum to the plan on 8 May 2009. The plan identified the systems and practices that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.
5. The examination plan also included the criteria that we used to examine the Corporation’s systems and practices. These criteria were selected for this examination in consultation with the Corporation. The criteria were based on our experience with performance auditing and our knowledge of the subject matter. The criteria and the systems and practices we examined are listed in **About the Special Examination** at the end of this report.
6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the circumstances. In carrying out the special examination, we relied on the work of the Corporation’s Audit and Consulting Services on

payout simulation and the Enterprise Risk Management controls and oversight validation.

7. In our opinion, based on the criteria established for the examination, there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the Corporation's systems and practices.

8. The rest of this report provides an overview of the Corporation and more detailed information on our examination observations and recommendations.



Clyde M. MacLellan, CA
Assistant Auditor General for the Auditor General of Canada

Ottawa, Canada
20 July 2009

Overview of Canada Deposit Insurance Corporation

9. In Canada, federal oversight of and the safety net for deposit-taking institutions is divided into specific functions. These functions are carried out by separate federal bodies.
- The **Minister of Finance** is responsible for federal public policies for federal deposit-taking institutions and for fiscal policies for the whole country. This includes being responsible for legislation that applies to deposit-taking institutions, including the *Canada Deposit Insurance Corporation Act*, the *Bank Act*, the *Trust and Loan Companies Act*, the *Office of the Superintendent of Financial Institutions Act*, the *Canadian Payments Association Act*, the *Cooperative Credit Associations Act*, and the *Bank of Canada Act*.
 - The **Office of the Superintendent of Financial Institutions** regulates federally incorporated financial institutions. These include banks, federal trust companies, federal loan companies, federal insurance companies, and pension plans.
 - The **Financial Consumer Agency of Canada** regulates the activities of financial institutions that are under federal jurisdiction. The Agency's focus is ensuring that these institutions comply with consumer protection laws, regulations, and codes.
 - The **Bank of Canada** is responsible for setting monetary policy and generally promoting the economic and financial well-being of Canada. The Bank of Canada oversees the system of major payments, clearing, and settlement in Canada, and has the power to act as a lender of last resort.
 - The **Canada Deposit Insurance Corporation** has the following mandate:
 - a. to provide insurance against the loss of part or all of deposits;
 - b. to promote and otherwise contribute to the stability of the financial system in Canada; and
 - c. to pursue the objects set out in (a) and (b) for the benefit of persons having deposits with member institutions and in such manner as will minimize the Corporation's exposure to loss.
10. The Governor in Council may, by order-in-council, exempt the Corporation from the requirement to pursue its objects. The exemption may be granted if pursuing the object might have an adverse effect on the stability of the financial system in Canada or on public confidence in that stability.

11. The Canada Deposit Insurance Corporation was created in 1967 under the *Canada Deposit Insurance Corporation Act*. The Corporation is accountable to Parliament, through the Minister of Finance. Its head office is located in Ottawa, and there is also an office in Toronto. As of 31 March 2009, the Corporation had 97 permanent employees.

12. The Corporation insures eligible deposits held in each member institution up to a maximum of \$100,000 per depositor. Eligible deposits must be payable in Canada, in Canadian currency, and they include

- savings accounts and chequing accounts;
- guaranteed investment certificates and other term deposits with an original term to maturity of five years or less;
- money orders, certified cheques, and bank drafts issued by Corporation members; and
- debentures issued by loan companies.

13. Schedule I and II banks (as defined by the *Bank Act*) that take retail deposits are required to be members of the Corporation, as are federally incorporated trust and loan companies and retail associations (as defined in the *Cooperative Credit Associations Act*). Provincially incorporated trust and loan companies that are authorized to accept deposits may be approved for deposit insurance. The Autorité des marchés financiers insures deposits that any provincially chartered trust and loan company holds in Quebec, and the Corporation insures deposits held by these companies outside Quebec. As of 31 December 2008, the Corporation had 80 member institutions—down from 82 in 2004, when we conducted our previous special examination. The decline was a result of consolidations and exits from the sector.

14. The Corporation does not receive parliamentary appropriations to carry out its work. Rather, it is funded by premiums that it assesses on the insured deposits of member institutions. Once a year, it rates and classifies member institutions according to four categories. Category 1 is the best rating, and Category 4 is the worst. Each member institution is assessed based on quantitative and qualitative factors and criteria. The rates for premiums double from one category to another. For example, in 2008, a Category 1 member institution paid 1/72nd of 1 percent of its insured deposits, a Category 2 member paid 1/36th of 1 percent of its insured deposits, and so on. As total premiums are a factor of the deposits for each level, any increase in deposits results in an increase in premiums. Exhibit 1 shows the

classification of members from 2005 to 2008 and shows that the percentage of member institutions in worst categories is on the rise.

Exhibit 1 Percentage of Member Institution by Category

Category	2005	2006	2007	2008
1	81%	84%	93%	75%
2	18%	14%	6%	20%
3	–	2%	1%	5%
4	1%	–	–	–

Source: Canada Deposit Insurance Corporation, 2009 Annual Report and current information

15. Market volatility and the credit crisis have also affected depositors, as seen by recent shifts into insured deposit products. The total amount of insured deposits increased by 17 percent between 2005 and 2008.

16. The Corporation's three major corporate objectives are as follows:

- **Strengthening Core Expertise and Readiness.** The Corporation must stay alert to developments that affect it and its membership. It must also ensure that it has the ability to anticipate and react to events and to manage insurance risk. The Corporation will focus on solidifying expertise in its core operational areas of insurance, risk monitoring, intervention, and resolution.
- **Promoting Depositor Awareness.** The Corporation must work to increase public awareness of deposit insurance, including its benefits and limits. Through its targeted long-term strategy, it will carry out public awareness campaigns that build on past initiatives.
- **Sustaining Efficient Governance and Operational Capacity.** To maintain the public's confidence, the Corporation must show that it is fulfilling its mandate efficiently and effectively. It will take steps to manage its significant risks, maintain sound governance, and continue to work actively with all its key stakeholders. Stakeholders include member institutions, the depositing public, employees, members of the Financial Institutions Supervisory Committee (FISC), regulators, parliamentarians, other deposit insurers in Canada and around the world, and relevant international organizations with an interest in deposit insurance issues.

17. The recent global financial crisis and economic downturn have had an effect on the Corporation, its membership, and the Canadian financial sector. In its 2009–10 to 2013–14 Summary Corporate Plan, the Corporation noted that the Canadian economy was being weighed down by turmoil in the international financial market, broad loss of confidence, and a recession in the United States. The outlook for the world economy had deteriorated significantly, and the global recession was expected to be broader and deeper than anticipated. In the Corporation's view, the key economic risk during its 2009–10 to 2013–14 planning period was that continuing instability in the global financial sector, as well as a US economy in recession, may cause pressures that would negatively affect Canada.

18. Also, in 2009, the Corporation noted in its Annual Report that the marked decline of global financial markets, along with Canada's weakening economic performance, particularly in the last quarter of 2008, contributed to a significant drop in profitability for Corporation member institutions in 2008. Larger banks continued to be challenged by their loan exposures to the US and by losses on complex securities and derivatives. Weaker economic conditions in Canada could have caused asset quality and the performance of member institutions to deteriorate.

19. The Corporation sees strengthening core expertise and readiness as a key strategy, as it may have to address a member failure in light of the key risks in the economic environment. More depositors are actively seeking information about protecting their savings, which directly addresses the Corporation's objective of promoting depositor awareness.

20. For the year ending 31 March 2009, the Corporation had \$146 million in revenues, and it recorded a net loss of \$37 million—its first loss since 1995. The loss resulted from an increase in the provision for insurance losses to reflect the rising risk in the environment. As at 31 March 2009, the Corporation reported a provision of \$800 million. This estimated figure is based on a number of inputs, including the level of insured deposits, the expectation of default taken from probability statistics, and the Corporation's specific knowledge of its members' defaults.

Focus of the special examination

21. We examined systems and practices of the Canada Deposit Insurance Corporation in the areas of corporate governance, strategic direction and risk management, intervention and risk assessment, and

human resources. Our objective was to see whether the Corporation has the systems and practices to provide reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

Bridge banking institution—A temporary bank established and operated to acquire the assets and assume the liabilities of a failed institution until final resolution can be accomplished.

22. The 2009 *Budget Implementation Act* received royal assent on 12 March 2009. The Act, which amended the *Canada Deposit Insurance Corporation Act*, will have a major impact on the Corporation's operations. It now has more flexibility when it responds to systemic risk concerns that arise from its members' failures. Amendments include providing authorization to create a **bridge banking institution**, increasing borrowing limits, and holding or acquiring shares in member institutions (subject to Minister's approval and conditions). The amendments also give the Corporation greater flexibility in when it times preparatory exams (see paragraph 77 for information on preparatory exams). Because these changes are fairly recent, there was not enough time for the Corporation to set up any full systems and practices before we conducted our examination. As a result, we did not include these new measures in our special examination report.

23. Further details on the audit objectives, systems and practices, and criteria are provided in **About the Special Examination** at the end of this report.

Observations and Recommendations

Corporate governance

24. Corporate governance refers to the structures, systems, and practices for overseeing the direction and management of an organization so it can carry out its mandate and achieve its objectives. Sound practices in corporate governance are essential to meeting the objectives relating to Crown corporations that are outlined in Part X of the *Financial Administration Act*.

25. We expected Canada Deposit Insurance Corporation to have a corporate governance framework that performs well and meets best-practice expectations for Board stewardship, shareholder relations, and communications with stakeholders and the public.

26. When we reviewed corporate governance practices, we looked at the following elements:

- roles and responsibilities, independence, capability, and membership of the Board of Directors;
- the Board's self-assessment and evaluation of the Chief Executive Officer;
- training given to the Board and the Board's oversight;
- stewardship in implementing International Financial Reporting Standards (IFRS);
- ethics and values;
- the Audit and Consulting Services; and
- communication with the shareholder and stakeholders.

27. We found that the Corporation has a corporate governance framework that performs well and meets best-practice expectations for Board stewardship, shareholder relations, and communications with stakeholders and the public.

The Corporation has the key elements of a good governance framework

28. The Corporation's Board of Directors is made up of the Chair, five private sector members, and five ex officio directors (the Governor of the Bank of Canada, the Deputy Minister of Finance, the Superintendent of Financial Institutions, a Deputy Superintendent of Financial Institutions appointed by the Minister or an officer of the Office of Superintendent of Financial Institutions, and the Commissioner of the Financial Consumer Agency of Canada).

29. Currently, the Board has four standing committees: The Executive Committee, the Audit Committee, the Human Resources and Compensation Committee, and the Governance and Nominating Committee. Each committee operates under terms of reference approved by the Board and reports regularly to the Board. All terms of reference are reviewed and updated regularly.

30. New directors receive the Directors' Manual, which includes

- their statutory responsibilities;
- the Board and its committees' terms of reference;
- key corporate information, such as the organizational structure,

- Board-approved policies, the code of conduct and ethical behaviour, and the conflict of interest requirements; and
 - federal government Crown corporation governance documents.
- 31.** Directors also have access to ongoing training and are informed of training and education opportunities. This training is tracked and reported to the Board.
- 32.** A profile of directors reveals that, collectively, Board members have the knowledge to carry out their responsibilities. Members of the Audit Committee have financial capabilities to challenge and review financial statements and the associated management discussion and analysis. The Audit Committee meets regularly with the external auditors. The Board communicates regularly with the Corporation's President and Chief Executive Officer and senior management. Directors hold part of their meeting without management present, which makes the Board more independent.
- 33.** Periodically, the Board assesses its own performance and the performance of its committees, and it assesses the performance of the President and Chief Executive Officer annually. Regular assessments help identify ways to improve practices and identify skills and abilities that need to be added to the Board or its committees.
- 34.** Management gives the Board the credible and timely information that it needs to administer the Corporation's affairs, to provide management with strategic direction, and to exercise its own oversight responsibilities. The material and presentations, which are thorough, are well prepared and set out the issues clearly. Management presents an executive summary on each topic and provides additional information if needed.
- 35.** The Accounting Standards Board of The Canadian Institute of Chartered Accountants has adopted a strategy to converge Canadian Generally Accepted Accounting Principles with the International Financial Reporting Standards (IFRS). The Corporation will be required to report under IFRS for the year ending 31 March 2012, and will be required to use IFRS-compliant comparatives for the year ending 31 March 2011. Its management developed a five-phase conversion plan, which was presented to and approved by the Board. Management provides a status report at each Board and Audit Committee meeting, which enables the members to exercise the necessary stewardship.

36. The Board-approved code of conflict of interest is updated regularly. The code is communicated throughout the Corporation and mandatory training is provided to all employees. Upon commencement of employment and then annually, all employees and Board directors complete conflict of interest declarations. The Human Resources and Compensation Committee reviews overall employee results and gives these to the Board. The Board approved a code of conduct and ethical behaviour for employees and a separate code for directors. Employees certify in writing upon employment, and Board members upon appointment, that they will abide by the oath and conflict codes.

37. The Corporation's Audit and Consulting Services (A&CS) is a key element of corporate governance, as it assures senior managers and the Board that important financial, administrative, and operational activities are carried out efficiently and effectively. A&CS meets this aim by delivering assurance engagements for a variety of processes. For its 2009–10 fiscal year, planned assurance engagements include a review of the valuation model, a review of website capacity, and a review of options and processes for non-payout interventions. A&CS also provides assurance and advisory services on initiatives such as systems development, IFRS, Internal Control over Financial Reporting (ICFR), and project management. It informs the Audit Committee of the results of all its engagements, and monitors the progress of recommendations until they are fully addressed.

38. The Institute of Internal Auditors (IIA) requires that an assessment of A&CS activities be done at least every five years by a qualified, independent reviewer from outside the organization. A public accounting firm reviewed the activities of A&CS in 2006 and reported that A&CS policies, procedures, processes, and practices complied with the International Standards for the Professional Practice of Internal Auditing. A&CS addressed the report's recommendations for improvement.

The Corporation communicates in a timely way and cooperates with stakeholders

39. The Corporation communicates with its shareholder, the Government of Canada, for statutory purposes, for example, through its Annual Report and the approval of the Corporate Plan. The Corporation's mandate is clearly described in its Act. The participation of the Deputy Minister of Finance on the Board of Directors provides opportunities to identify issues and to determine whether any further meetings are to be held between the Corporation and the shareholder.

40. The Corporation must nurture, evaluate, and keep improving its relationships with its stakeholders. Each year, the Corporation identifies all of its stakeholders. Its main stakeholders are the Office of the Superintendent of Financial Institutions (OSFI), the Department of Finance, the Bank of Canada, and the Financial Consumer Agency of Canada. Communications with OSFI, the Department of Finance, and the Bank of Canada are discussed further in the intervention and risk assessment section of this report.

41. The Corporation communicates with other stakeholders, such as the Canadian population, through annual public meetings, brochures, public reports, and advertisements. The economic environment and corporate initiatives influence the frequency of communications with stakeholders. We noted that in the current economic environment, communications with stakeholders were more frequent.

42. In addition, the Corporation communicates regularly with member institutions, which it also considers to be stakeholders, about questions pertaining to its bylaws. When necessary, it communicates with member institutions about other issues, for example, when results of a member institutions' risk assessment warrant increased monitoring.

43. As required by Corporation bylaws, member institutions submit all necessary information. The Corporation sends to individual employees (on a need-to-know basis) the information they need to execute the work requirements. We noted that the Corporation classifies and manages its information at the assigned level of security.

Strategic direction and risk management

44. Strategic planning guides what an organization is, as well as what it does and why, with an eye to the future. Such planning includes assessing and adjusting the organization's direction when something changes in its environment and in the risks it faces. The Board of Directors and management of Canada Deposit Insurance Corporation work together to build a view of the Corporation's future. The Corporate Plan ultimately guides the setting of corporate objectives and the allocation of resources, and the results are included in the Corporation's Annual Report.

45. We expected the Corporation to have clearly defined strategic directions and specific and measurable goals and objectives to achieve its legislative mandate. The Corporation's strategic direction and goals should take into account its mandate, address identified risks, and recognize the need to control and manage its resources economically and efficiently.

46. In reviewing strategic direction and risk management, we looked at the following elements:

- assessment of the internal and external environment and of organizational strengths and weaknesses,
- the process for setting strategic direction,
- agreement between the strategic direction and how it is communicated,
- the reporting of performance measurement, and
- integrated risk management and communication.

47. We found that the Corporation has clearly defined its strategic direction. It has taken into account its mandate and the need to control and manage its resources economically and efficiently, and it has addressed identified risks. The Corporation has defined measurable goals and objectives; however, there are some opportunities for improvement in performance reporting.

Sound planning practices are in place to provide clear direction

48. The Board of Directors works with senior management to set out the Corporation's strategic direction. The Corporation develops a five-year Corporate Plan that is in keeping with its mandate, and updates it annually. The plan is based on a sound analysis of the Corporation's business environment and the key risks it faces. The Corporate Plan

- includes the key strategies for the planning period and specific deliverables that must be addressed in the short term;
- takes into account the changing environment, the human and financial resources required to achieve the Corporation's goals, and the need to control and protect its assets;
- allows for identified risk, as the planning process is integrated with the enterprise risk management systems and practices; and
- is approved by the Board and by the Governor in Council on the recommendation of the Minister of Finance.

49. The operational plans of the Corporation's various business units set out these deliverables further, in enough detail to guide management action and assign responsibilities. Once a year, the Corporation holds a meeting with all its employees to update them on the operating environment, the risks the Corporation is facing, and the key planning assumptions for the planning period.

The Corporation has a good, integrated approach to enterprise risk management

50. Risk management involves setting the best course of action by identifying, assessing, accepting, understanding, acting on, monitoring, and communicating risk issues. Integrated risk management is a continuous, proactive, and systematic approach to understanding, managing, and communicating risk from an organization-wide perspective. This approach is about making strategic decisions that help to achieve an organization's overall corporate objectives. The Corporation must manage risks at different levels. For example, in addition to managing the corporate risks it faces itself, the Corporation must also manage the risks that arise from its membership. The management of these risks is discussed in the intervention and risk assessment section of this report.

51. In our 2004 special examination report, we noted concerns about the timing, content, and clarity of enterprise risk management reports. The Corporation's enterprise risk management is now well developed, and reporting has improved since the last special examination. Management reports its risk assessment to the Audit Committee and the Board once a year and includes a one-page overview for each significant risk. Management also informs the Board of any major changes or new risks identified between reporting periods.

52. The Corporation's risk management is governed by an enterprise risk management framework and Board risk policies. Roles and responsibilities are clearly defined and assigned. The Board and its Audit Committee oversee the

- functioning of the Corporation's approach to enterprise risk management,
- appropriateness of risk ratings, and
- integration of enterprise risk management with planning and decision making.

53. Since 2007, management has provided the Board with an enterprise risk management letter of representation. This letter is published in the Corporation's Annual Report.

54. Management does annual risk assessments. Each risk owner gives an update on risks that were identified earlier and the results of the assessment. An enterprise risk management committee confirms the risk reports. Once the committee has confirmed the assessment of all of the Corporation's significant risks, it assesses the relative significance of each risk. The Corporation has identified four general

areas of risk and thirteen sub-risks; it continually assesses its risk universe based on the potential likelihood and impact of various risks. It compares these assessments with previous ones, determines trends, and undertakes relevant risk initiatives to support or enhance risk management.

55. As part of enterprise risk management, the owners of the general areas of risk (financial, insurance, operational, and reputation) identify the controls and oversight that exist or that need to be put in place to manage each specific risk. Once a year, Audit & Consulting Services (A&CS) validates that management's controls and oversight are in place.

56. All decision making within the organization, at each level of importance and significance, involves considering risk and applying risk assessment to some degree. To reduce the potential for conflict of interest, the Director of Corporate Risk (who is responsible for enterprise risk management) is independent from high-risk functions, including Intervention, Treasury, and Finance.

Performance measurement and reporting could be improved

57. Measuring and reporting on performance are important steps in making sound decisions, holding management accountable for its use of resources, and communicating to Parliament and stakeholders how well the Corporation is fulfilling its strategic objectives.

58. Since our 2004 special examination, the Corporation won the 2005 Award for Excellence in Annual Reporting by Crown Corporations, from the Office of the Auditor General of Canada, and the 2007 Award of Excellence for Corporate Reporting, from The Canadian Institute of Chartered Accountants.

59. The Corporation has developed a set of key performance indicators for each of its initiatives. It outlines its progress in the Annual Report, informing readers of short-term achievements (Exhibit 2).

60. Measuring and showing the results and impact of initiatives is a challenge for many organizations. To describe performance, it is necessary to explain the key strategies that transform resource inputs into relevant activities and intended results. There are two kinds of results: outputs (the direct products) and outcomes (service the Corporation provides). Outcomes are the consequences of those

Exhibit 2 An example of some key performance indicators as they relate to one of the Corporation's corporate strategies**Canada Deposit Insurance Corporation's Corporate Scorecard—2008–09 to 2012–13**

Corporate objectives: Provide deposit insurance and contribute to the stability of the financial system, for the benefit of depositors, and while minimizing the Corporation's exposure to loss.

Corporate strategies: Strengthening Core Expertise and Readiness. The Corporation must stay alert to developments that affect the Corporation and its membership. It must also ensure that it has the ability to anticipate and react to events and to manage insurance risk. The Corporation will focus on solidifying expertise in our core operation areas of insurance, risk monitoring, intervention and resolutions.

Planned key initiatives	Key performance indicators	Status
Insurance Program and Powers <ul style="list-style-type: none"> Return of Insured Deposits: Consultation with member institutions about premium assessment base. <i>Joint and Trust Account Disclosure By-law:</i> Undertake comprehensive review. <i>Deposit Insurance Information By-law:</i> Update internal clearance system. Amendments to Corporation differential premiums system to address Basel II. 	<ul style="list-style-type: none"> Return of Insured Deposits and by-laws are current and relevant, and take into account member institutions' input. Consultation with members completed and appropriate amendments made to the differential premiums system for the 2010 premium year. 	<p>○</p> <p>○</p>
Membership Risk Monitoring <ul style="list-style-type: none"> Training for Corporation risk managers in support of changes reported by member institutions respecting Basel II, International Financial Reporting Standards (IFRS), fair value accounting and other changes. 	<ul style="list-style-type: none"> Basel II training completed by March 2009 and other training programs ongoing throughout the planning period. 	<p>○</p>
Readiness for Payout <ul style="list-style-type: none"> Undertake the Payout Capacity Enhancement Project: Conduct annual end-to-end and limited scope simulations to test existing capacity and enhancement project progress. 	<ul style="list-style-type: none"> Achievement of annual project milestones for each year up to completion of the project as evidenced by the Corporation's ability to conduct a large payout, while always maintaining existing capacity in full readiness—by March 2012. 	<p>○</p>
Readiness for Non-payout Resolutions <ul style="list-style-type: none"> Review and update the valuation model. Maintain current, optimal resolution methods by member peer group—a “toolbox” of non-payout failure resolution strategies and supporting documentation. Ensure all Risk Managers are trained on special examination methodologies and on the valuation model. 	<ul style="list-style-type: none"> Valuation model reviewed and updated as required during the planning period. All risk managers up-to-date on the use of current non-payout strategies, special examination methodologies, and the valuation model via tailored and ongoing training program. 	<p>○</p> <p>◐</p>

Legend:

- Planned progress on schedule and within budget.
- ◐ Slippage in terms of time to completion, and/or budget variances.
- Cancelled or deferred.

Source: Canada Deposit Insurance Corporation 2009 Annual Report

outputs for Canadians, including depositors and stakeholders. The Corporation has presented output information in relation to the corporate strategy of Strengthening Core Expertise and Readiness (Exhibit 2). However, this information does not show the impact of Corporation initiatives on Canadians.

61. Also, the summary corporate plan does not mention whether the corporate strategy was achieved or partly achieved. For example, under the corporate strategy of Strengthening Core Expertise and Readiness, the Corporation could report on its state of readiness, which it achieved and maintained to provide deposit insurance when needed. It could also report the level of staff expertise in core operational areas of insurance, risk monitoring, intervention, and resolutions.

62. Good practice in performance reporting involves assessing results at different points in time—in the short, medium, and long term. In this way, it is possible to follow progress toward corporate strategies. These milestones for results are used because of the length of time it takes before the impact of initiatives can be seen on long-term corporate strategies. In our view, more information is needed on the intended and actual results of the initiatives over time, which will help to inform parliamentarians and stakeholders about the progress being made in achieving the corporate strategies.

63. In addition, although the Corporation presents corporate financial information in its Annual Report, it does not align that information with its corporate strategies. In order to achieve this, the Corporation could allocate the necessary resources to each strategy. For example, in the 2008–09 fiscal year, the Corporation had over \$25 million in operating expenses, half of which were personnel costs for its staff of 97 permanent employees. However, it did not break this information down by corporate strategy in its Annual Report.

64. Showing the link between financial information and other information will help users of the Annual Report better understand the resources given to achieving corporate strategies. This practice will also provide a better means of assessing the cost of achieving the desired results. We encourage the Corporation to develop an estimate of costs incurred for each of its strategies. Such approximations should be cost-effective: providing meaningful estimates without being overly costly to the Corporation. Options include using an allocation formula that is based on the estimated time spent working on a given strategy and using the results of prorating numbers of employees per strategy against the total cost incurred.

65. Recommendation. The Canada Deposit Insurance Corporation should develop intended outcomes for all of its corporate strategies and report its progress toward achieving them.

The Corporation's response. Management agrees. The Corporation recognizes the importance of excellence in reporting and always strives for continuous improvement in its public reporting. Management will reconsider its performance measurement and reporting practices with a view to improving the current presentation of identifiable outcomes in line with best practices. Management will also consider how it may be able to present a relationship between financial and non-financial information.

Any changes must continue to take into account the confidentiality of member information as well as the need to preserve the stability of the financial system. These changes will be incorporated in future reporting beginning with the 2011–12 Corporate Plan.

Intervention and risk assessment

66. Systems and practices for risk assessment of member institutions are intended to provide Canada Deposit Insurance Corporation with the information it needs to identify member institutions that pose an elevated insurance risk. With this information, it can take action to minimize its exposure to loss. Where action is required, intervention systems and practices allow the Corporation to resolve a potential or actual failure of a member institution. The intervention process is not a rigid one, and situations are not always addressed with a predetermined set of actions. Circumstances may vary significantly from case to case.

67. We expected that the Corporation

- would have identified as accurately as possible, in a timely manner, risks for member institutions, so it could take appropriate action to minimize its exposure to loss;
- would have the systems and practices to decide when to intervene and how;
- would have the relevant and requisite authority, capability, and readiness to intervene;
- would have management strategies and procedures in place to meet the statutory objectives; and
- would be maintaining good communication and cooperating well with other organizations.

68. These approaches are important for achieving the best outcome possible for depositors and for contributing to the stability of the Canadian financial system.

69. In reviewing intervention and risk assessment, we looked at the following elements:

- ongoing identification and assessment of risks posed by its member institutions;
- human, technological, and financial resources;
- management of timely and accurate payouts;
- legal authority; and
- communication and cooperation with other organizations.

70. We found that the Corporation has identified as accurately as possible, and in a timely manner, risks for member institutions so it can take appropriate action to minimize its exposure to loss. The Corporation has the

- systems and practices to determine when to intervene and how;
- relevant and requisite authority, capability, and readiness to intervene; and
- management strategies and procedures in place to meet the statutory objectives.

71. We also found that the Corporation maintains good communication and cooperates well with other organizations, which is important for achieving the best outcome possible for depositors and for contributing to the stability of the Canadian financial system.

Risks presented by member institutions are assessed regularly

72. The Corporation has developed a framework for assessing and reporting on the risk that each member institution represents. The Risk Assessment Methodology Manual outlines what actions should be taken and when they should be taken, and it ensures uniformity and consistency between risk assessments. The Corporation performs a risk assessment of all member institutions at least once a year. The risk assessment department also meets with examiners from the Office of the Superintendent of Financial Institutions to discuss member institutions and to ensure that the Corporation's assessment process is robust and complete. For high-risk members, assessments are more frequent, and the Corporation includes those members on a watch list.

73. In addition to monitoring member institutions through the risk assessment process, the Corporation’s risk assessment department looks at financial information, regulatory information, market information, and environmental issues. This information allows the department to keep track of developments that affect Corporation members, in particular, and the financial services sector, in general. The annual membership review—a comprehensive analysis of financial, market, regulatory, economic, and emerging issues in Canadian banking—uses the results of this monitoring and risk assessment of individual member institutions. Corporation management presents the results of the membership review, and the monitoring of watch-list members, to the Board. Based on the risk assessment, management proposes and obtains Board approval for the actions to be followed.

Processes are in place to ensure access to resources

74. To undertake an intervention or a payout, the Corporation needs more resources than usual (people to do the work), as well as technological and financial resources. The required resources depend on the size and complexity of the member institution. The Corporation operates with a core number of expert employees. To deal with specific challenges, it adds to these skills where necessary. It does so by contracting and working with liquidators or receivers, and by using “workout” or “wind-down” arrangements. These arrangements may include hiring more employees, contract personnel, consultants, insolvency and legal professionals, and other service providers.

75. Since our last special examination, the Corporation has signed or is negotiating standby agreements with professional firms to ensure that sufficient human and technological resources will be available if needed. We look at the Corporation’s own human resource needs in more detail in the final major section of this report.

76. To meet financial demands, the Corporation can use its investment portfolio as its initial source of funding. This portfolio was fair valued at \$1.8 billion as of 31 March 2009. The Corporation can also borrow from the **Consolidated Revenue Fund** and can issue bonds, debentures, or other vehicles, for an amount of \$15 billion or any amount authorized by Parliament through an appropriation act. The borrowing limit is to be adjusted for the growth in insured deposits.

Consolidated Revenue Fund—The total of all public monies that are on deposit at the credit of the Receiver General for Canada and from which most government expenditures are made.

Preparatory examinations (conducted by the Canada Deposit Insurance Corporation or by a designate)—An examination of the books, records, and accounts of a member institution relating to its deposit liabilities. Conducted when the Corporation believes it would be in the best interest of both the depositors and the Corporation to prepare to make that payment as soon as possible.

Special examinations (conducted by the Canada Deposit Insurance Corporation or by a designate)—A special examination can be undertaken for a specified purpose, at such times as the Corporation may require. It can involve a detailed examination during which the Corporation examines a bank's assets and deposit liabilities, to compare payout and non-payout intervention strategies, to estimate and minimize its potential exposure to loss.

77. Technology is another essential resource for the Corporation. A key challenge is collecting knowledge or information on insured deposits from member institutions. The Corporation is allowed to perform its **preparatory examination** or **special examination** when a member institution presents some concerns. It can upload a member institution's information about that member institution's assets when it wants to carry out **special examinations** to assess risks, or when it wants to decide on an appropriate course of action. The Corporation obtains information about insured deposits primarily by way of preparatory examinations.

78. Because member institutions use different systems, uploading information is a major factor in achieving an efficient intervention or payout. The Corporation has learned about its systems by uploading information in the past and by conducting simulation exercises. To add to its knowledge of members' systems, the Corporation initiated a process for getting information on the watch-list member's deposit data system. This information is validated by deposit data samples from those institutions.

79. Also, the Corporation initiated a project that will add to the knowledge it has of all member institutions' deposit data systems and that management believes will allow it to upload information more quickly when necessary. We encourage the Corporation to continue this initiative and to gather knowledge or information about data on insured deposits as, by doing so, it will be ready to intervene if necessary.

Readiness for interventions and payouts has improved

80. Since the Office of the Auditor General's last special examination, in 2004, no payout was performed. However, the Corporation did conduct one preparatory examination, which gave assurance that its systems and practices are working as intended. Furthermore, the Corporation performs annual simulations to test its capacity to perform payouts, as well as to train employees. The Corporation tests its systems and practices through these simulations, considering new payment mechanisms and member institutions of different sizes and complexity. Audit and Consulting Services monitors the simulation exercise and notes opportunities for improvement. These improvements are monitored and reported to the Audit Committee until they are addressed.

81. In our last special examination of the Corporation, in 2004, we reviewed a number of draft documents on processes and systems. We encouraged the Corporation to finalize these documents to support timely, appropriate interventions or payouts in the future. The Corporation has developed and finalized its guidelines for each of the steps involved in payouts and has created a payout process background document that describes the payout roles, responsibilities, and timing.

82. During our 2004 special examination, we encouraged the Corporation to update and document its valuation model to enhance its readiness for intervention. In spring 2005, the Corporation updated and documented its valuation model, using internal resources and external development support. The model was reviewed in March 2009.

83. The Corporation uses the valuation model to assess various intervention methods in a given situation and to estimate its potential losses due to member failures. The valuation model takes data drawn directly from a failing member institution and uses a series of assumptions to produce detailed financial forecasts. The model provides for multiple scenarios, from realistic to more severe. In April 2009, the Corporation tested the valuation model and used the opportunity to train its employees.

84. In our 2004 special examination, we also noted that the Corporation's Insurance and Risk Assessment division had developed concrete measures of the Corporation's level of readiness to deal with future interventions—according to member institution peer group, for example, large banks and member institutions specializing in real estate or trusts. However, we noted that it had not applied these measures to all types of member institutions. Also, it had not indicated the readiness of other divisions besides risk assessment.

85. We encouraged the Corporation, in our 2004 special examination, to assess the readiness of all key parts of the organization for each member institution peer group and to report its findings to the Board. We recommended that these reports clearly identify risks and outline strategies to offset them. The Corporation put a framework in place that includes assessments of readiness by peer group, preliminary assessment of readiness for payout, and other resolution methods by peer group. Management presented the framework and the results of the readiness assessment to the Board in stages.

86. The Corporation must be prepared to intervene quickly and appropriately in the affairs of a troubled member institution. The aim of the intervention process is to identify areas of concern and intervene early to

- minimize depositors' losses,
- contribute to the stability of the financial system, and
- minimize the Corporation's exposure to loss.

87. The Corporation has a wide range of discretionary powers that allow it to intervene to address concerns in member institutions. It ensures that it is ready for an intervention or a payout by giving employees guidelines on preparatory examinations and payouts and has created a special examination manual. The Corporation has outlined in its watch list manual the policies and procedures for its watch list process.

88. The Corporation and the Office of the Superintendent of Financial Institutions developed a guide to intervention to describe their possible actions and coordination mechanisms at each stage of intervention. The Corporation has also developed other guidelines that apply in interventions. However, assessments made throughout the intervention process are made with the Board's input and with the consideration of the unique circumstances of the member institution, such as nature, scope, complexity, and risk profile. As a result, selecting the appropriate intervention process is not a rigid decision. Every situation is not necessarily addressed with a predetermined set of actions. Rather, the approach may vary widely from case to case.

89. Another way that the Corporation can ensure it is ready to intervene is to keep its employees up to date about changes experienced by member institutions, payout resolution methods, and key intervention tools. The Corporation gives employees coaching and in-house training. For example, it recently provided training on its updated special examination manual and related information on valuation and internal training on new accounting standards and capital rules found under the **Basel II Accord**. As a training tool and readiness assessment exercise, the Corporation does comprehensive end-to-end intervention simulations.

90. To help adapt its systems and practices to the current business environment, the Corporation developed a new payment mechanism. This new mechanism allows depositors to access funds sooner, because payments are made in instalments, and allows the Corporation to

Basel II Accord—Initially published in 2004 and now being implemented by national bank supervisory authorities. The accord describes a more comprehensive measure and minimum standard for capital adequacy (the level of capital funds in place given the ratio of total assets to capital). It seeks to improve on the 1988 Basel 1 Accord by aligning regulatory capital requirements more closely to the underlying risks that banks face. Basel II is intended to promote an approach to capital supervision that will evolve with advances in markets and risk management practices.

complete the payout calculation. Remote users can access the system securely; the information remains private. This new payout mechanism was tested in both the 2008 and 2009 simulations.

91. The Corporation's legal powers are essential to its ability to fulfill its mandate. It uses enterprise risk management to analyze its powers and identify additional powers that would help achieve its mandate. The Corporation has a number of intervention powers that support the resolution of a member failure, including those that do not involve payouts to depositors, such as bridge banking, which it identified in 2007 as an additional power that would help it fulfill its mandate. A bridge institution is a temporary bank established and operated to acquire the assets and assume the liabilities of a failed institution until the situation is resolved. The Corporation believes that this measure would minimize the disruption of service to customers. This new power was announced in the 2009 Budget and came into force on 1 July 2009.

The Corporation maintains good internal communications and cooperates well with other organizations

92. Good communication is a key factor in ensuring the success of an intervention or payout. The Corporation's management keeps its Board of Directors informed of all stages of an intervention or payout, and special Board meetings are scheduled if issues arise.

93. The Corporation outlines bilateral responsibilities for each of its stakeholders; for example, it has a Strategic Alliance Agreement with the Office of the Superintendent of Financial Institutions. It also maintains relationships with its main stakeholders through memberships on the Senior Advisory Committee, which focuses on policy decisions, and the Financial Institutions Supervisory Committee, which focuses on supervisory issues with respect to member institutions and other federally regulated entities. The Office of the Superintendent of Financial Institutions, the Department of Finance, the Bank of Canada, and the Financial Consumer Agency of Canada are also members of these committees. The Corporation works with its stakeholders to assess and intervene in member institutions, and provides input on proposed or possible amendments to the *Canada Deposit Insurance Corporation Act*. Management informs the Board about key discussions with stakeholders.

Human resources

94. Satisfied and motivated employees are vital to the Canada Deposit Insurance Corporation's ability to achieve the enviable position of excellent employer and to be considered an organization that operates with the highest professional standards. The Corporation's demographic profile, as it operates with a core of expert employees, and the operating environment itself require an approach to human resource management that can adapt to and meet changing needs.

95. We expected that the Corporation would have systems and practices in place to manage its human resources in a way that gives it the core competencies and skills it needs to meet its strategic and operational objectives.

96. In reviewing the Corporation's human resources, we looked at the following elements:

- planning, recruitment, and allocation of staff;
- learning and development; and
- succession planning.

97. We found that the Corporation has the systems and practices in place to manage its human resources. The Corporation thus has the core competencies and skills it needs to meet its strategic and operational objectives.

The Corporation regularly assesses its human resource needs

98. The Corporation gathers qualitative and quantitative data about its demographics, retirement eligibilities, and attrition as well as the number of positions it has. It measures employee satisfaction regularly to ensure that there are no obstacles to having a productive and motivated workforce. Its 2007 results were positive, surpassing the external benchmarks, which were set through **Mercer's What's Working survey**, in most areas.

99. The Corporation created its strategic initiatives for human resources through its human resource strategy and plan, which currently focus on the ongoing development of excellence of employees and of the Corporation as an employer. The Corporation regularly presents progress reports to the Human Resources and Compensation Committee and to the Board. It will design and implement a new human resources strategy and plan that includes set timelines. After reviewing its needs, the Corporation recently hired more employees to add to its intervention resources.

Mercer's What's Working survey—Created by Mercer (a consulting company that specializes in human resources), this survey analyzes trends in employee perception and identifies the key drivers of employee engagement.

100. As required under its training and professional development policy, the Corporation offers training to all its employees so that they may acquire, maintain, and develop their skills and competencies. It has also created a training and development framework that lists the skills and competencies needed by specific departments. All employees get this information to make sure that they meet the skills or competency requirements and to help them see what training they need. Training needs are set and discussed, and individual learning plans are developed, as part of the performance appraisal process.

101. The Corporation has a succession plan that identifies the key positions in the organization, the individuals capable of filling those positions, and the training those individuals need to carry out their roles. The Human Resources and Compensation Committee and the Board review the succession plan once a year.

Conclusion

102. We conclude that during the period covered by the examination, based on the criteria established for the examination, the Canada Deposit Insurance Corporation has maintained systems and practices that provide it with the reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

About the Special Examination

All of the audit work in this report was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objective

Under section 138 of the *Financial Administration Act* (FAA), federal Crown corporations are subject to a special examination once every ten years. Special examinations of Crown corporations are a form of performance audit where the scope is set by the FAA to include the entire corporation. In special examinations, the Auditor General provides an opinion on the management of the corporation as a whole. The opinion for this special examination is found on page 3 of this report.

Special examinations answer the question: Do the corporation's systems and practices provide reasonable assurance that assets are safeguarded and controlled, resources are managed economically and efficiently, and operations are carried out effectively?

Key systems and practices examined and criteria

At the start of this special examination, we presented the Corporation's Audit Committee with an audit plan which identified the systems and practices, and related criteria, that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. These are the systems and practices and criteria that we used for examination.

Key system and practice examined	Criteria
Corporate Governance	The Canada Deposit Insurance Corporation should have a corporate governance framework that performs well and meets best-practice expectations for Board stewardship, shareholder relations, and communications with stakeholders and the public.
Strategic direction and risk management	The Corporation should have clearly defined strategic directions and specific and measurable goals and objectives to achieve its legislative mandate. The Corporation's strategic direction and goals should take into account its mandate, address identified risks, and recognize the need to control and manage its resources economically and efficiently.

Key system and practice examined	Criteria
Intervention and risk assessment	<p>The Corporation should identify as accurately as possible, and in a timely manner, risks for member institutions, so it can take appropriate action to minimize its exposure to loss. The Corporation should have the systems and practices to determine when to intervene and how; have the relevant and requisite authority, capability, and readiness to intervene; and have management strategies and procedures in place to meet the statutory objectives.</p> <p>The Corporation should maintain good communication and cooperate with other organizations, which is important for achieving the best outcome possible for the depositors and for contributing to the stability of the Canadian financial system.</p>
Human resources	<p>The Corporation should have systems and practices in place to manage its human resources in a manner that provides it with the core competencies and skills to meet its strategic and operational objectives.</p>

Audit work completed

Audit work for this special examination was substantially completed on 20 July 2009. It covered the system and practices that were in place between 2 February 2009 and 30 June 2009.

Audit team

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Appendix List of recommendations

The following is a list of recommendations found in the Special Examination Report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Strategic direction and risk management	
<p>65. The Canada Deposit Insurance Corporation should develop intended outcomes for all of its corporate strategies and report its progress toward achieving them. (44–64)</p>	<p>Management agrees. The Corporation recognizes the importance of excellence in reporting and always strives for continuous improvement in its public reporting. Management will reconsider its performance measurement and reporting practices with a view to improving the current presentation of identifiable outcomes in line with best practices. Management will also consider how it may be able to present a relationship between financial and non-financial information.</p> <p>Any changes must continue to take into account the confidentiality of member information as well as the need to preserve the stability of the financial system. These changes will be incorporated in future reporting beginning with the 2011–12 Corporate Plan.</p>