Treasury Board and Finance—Oversight of Financial Institutions Follow Up

SUMMARY

The department[1] is responsible for maintaining the legislative framework for all provincially incorporated financial institutions and for supervising provincially regulated financial institutions to determine whether they are in sound financial condition and complying with legislation and supervisory requirements. The department does this through the Financial Institutions Regulatory Branch and the Financial Institutions Policy Branch.

The regulatory branch regulates and supervises the following entities:
- ATB Financial
- Credit Union Central Alberta Limited (AB Central), which is the central bank and liquidity provider for credit unions
- six provincially incorporated trust companies that do not take deposits

The policy branch maintains the legislative framework for provincially incorporated financial institutions including ATB, the Alberta credit union system, and trust companies. The policy branch is also responsible for assessing whether the government is receiving a fair return from ATB.

What we examined

In 2010, we examined whether the department had:
- clearly defined its expectations for ATB and had processes to monitor whether those expectations were met
- effective systems in place to monitor the safety and soundness[2] of ATB, AB Central and the six trust companies

We recommended in our April 2010 Report that the department:
- clarify its business objectives for ATB, in relation to the level of risk the department expects ATB to take
- develop an implementation plan for its approach to regulating and supervising regulated financial institutions
- complete risk assessments and evaluate the quality of regulated entities' risk management practices
- strengthen its processes to ensure identified legislative non-compliance matters are remediated
- identify which guidelines are applicable for regulated entities and develop processes to monitor compliance with the guidelines

To assess the department's progress in implementing our recommendations, we examined its activities from April 2010 to March 2013. We excluded the department's supervisory systems for trust companies from our follow up audit because we agreed with the department's assessment that the financial risk to

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[1] In our original audit, the department was the Department of Finance and Enterprise. It is now the Department of Treasury Board and Finance.

[2] For purposes of this audit, we take "safe and sound" to mean that entities comply with legislative requirements, maintain adequate capital and liquidity and follow good business practices to protect customer's deposits and assets from loss.

the province around these entities is lower than the risks for ATB and AB Central. Therefore, our focus was on the department's processes to regulate and supervise ATB and AB Central.

What we found

Over the past few years, the department has moved from an informal monitoring program to a risk-based[3] supervisory program. There is now active oversight occurring of provincially regulated financial institutions.

When we did our original audit, the department had recently developed its supervisory approach to monitor the safety and soundness of regulated entities. Only informal monitoring procedures were being done. This follow-up audit confirmed that significant components of the implementation plan have been put in place. The department is on schedule; however, it will take a few more years to finish implementing the complete plan.

The department has implemented our four recommendations on having effective systems in place to fulfill its responsibilities to monitor the safety and soundness of provincially regulated financial institutions. The department's plan for implementing its regulatory framework is a road map for achieving its objective of holding provincially regulated entities to similar regulatory and supervisory standards as other financial institutions.

The department has implemented our recommendation to clearly define its expectations for ATB and has processes to monitor whether expectations are met. The department uses a quantitative performance target to assess fair return, as well as ensuring that certain qualitative objectives are being met, such as ATB maintaining a presence in smaller communities.

Why this is important to Albertans

Expectations for ATB

Albertans should be able to assess whether ATB, as a crown corporation, is providing an appropriate return for the level of risk it is undertaking.

Regulatory branch

The Government of Alberta guarantees the full value of deposits held at ATB and Alberta credit unions. Albertans could be exposed to losses if ATB and AB Central are not operated in a safe or sound manner.

FINDINGS AND RECOMMENDATIONS

Improving accountability—implemented

Background

In 2010, we recommended that the department clarify its business objectives for ATB, within their memorandum of understanding (MOU), in relation to the level of risk the department expects ATB to take.[4] We noted that the department had not clearly defined the business objectives it expected ATB to achieve, because the department had not clearly defined a "fair return."

[3] A risk-based program identifies areas of higher risk, and focuses resources and effort to these areas.
[4] *Report of the Auditor General of Alberta—April 2010,* page 96.

Our audit findings

The department implemented our recommendation by creating a new mandate and roles document[5] (MRD) to improve the understanding of roles and responsibilities for ATB and the department as well as further defining what "fair return" means. The MRD was signed by both ATB and the department and replaces the MOU that was in effect during our original audit.

The MRD recognizes that ATB is not solely a commercial enterprise and that the government must take qualitative considerations into account when evaluating fair return. ATB fulfils certain policy objectives, such as maintaining a presence in smaller rural communities, and operates within an established level of risk set by the minister. Therefore, the MRD states that a fair return must be evaluated within constraints imposed and opportunities afforded it by government.

The department and ATB meet annually to review ATB's fair return and other matters identified by ATB's board and the Minister of Finance. ATB uses this information to create targets for its business plan, which the department annually reviews. The targets take various factors into account, including the department's requirements of ATB, risk parameters set by ATB's board, and level of risk set by the minister.

The target that ATB and the department agreed to use is a 1.0 per cent return on average risk weighted assets for the 2013–2014 fiscal year. The target increases to 1.1 per cent in the following two years. This ratio is calculated by taking net income for the year divided by ATB's average risk weighted[6] assets. The example below demonstrates how this metric would have been calculated for the year ending March 31, 2012:

Net income – year ended March 31, 2012 ($ thousands)	Average risk weighted assets – year ended March 31, 2012 ($ thousands)	Return on risk weighted assets – year ended March 31, 2012 (per cent)
195,100	21,795,000	0.90

We concluded this recommendation is implemented because the department has defined fair return and has a process to measure and monitor the results.

Implementation plan for regulatory and supervisory frameworks—implemented

Background

In 2010, we recommended that the department develop an implementation plan for regulating and supervising regulated financial institutions.[7] The department had a framework that set out its supervisory approach. An implementation plan would identify the crucial steps the department needed to take to implement the framework.

[5] http://www.finance.alberta.ca/business/agency-governance/agencies/A/ATB-Mandate-and-Roles.pdf
[6] Risk weighted assets are established for various on-balance sheet and off-balance sheet assets according to credit risk.
[7] *Report of the Auditor General of Alberta—April 2010,* page 97.

Our audit findings

The department created a five-year implementation plan to regulate and supervise financial institutions. We reviewed the plan and concluded that it appropriately sets out the department's approach over the next five years. The plan contains:

- key supervisory activities to achieve the department's regulatory objectives
- timelines for implementation
- projected resource requirements
- expected outcomes

We did note that some assumptions in the five-year plan were outdated, such as the number of supervisory staff available to the department. We encourage the department to update the plan when circumstances change that may affect the department's ability to implement the framework. To its credit, the department has generally been able to meet its schedule with fewer resources than anticipated.

Completion of risk assessments—implemented

Background

In 2010, we recommended that the department complete risk assessments and evaluate the quality of the regulated entities' risk management practices.[8]

The objective of a risk-based supervisory model is to:

- identify and evaluate risk within a financial institution
- assess the quality of the financial institution's risk management and control functions
- perform a combination of on-site examinations and off-site monitoring based on the organization's size, complexity, risk profile and financial condition

Our audit findings

The department implemented our recommendation by completing risk assessments for ATB and AB Central and then using the assessments to create risk-based supervisory plans for these entities.

The risk assessment for ATB was first completed for the fiscal year ending March 31, 2011, and has been updated annually. The risk assessment for AB Central was completed in October 2011. The risk assessment for AB Central incorporates results from consultations with the Government of Canada's Office of the Superintendent of Financial Institutions,[9] which also has regulatory responsibilities related to AB Central.

As part of its risk assessments, the department also evaluated the quality of risk management practices at ATB and AB Central.

Monitoring legislative compliance—implemented

Background

In 2010, we recommended that the department strengthen its processes to ensure identified legislative compliance matters are remediated.[10] As part of its approach to regulate and supervise, the department requires regulated entities to annually confirm their compliance (or identify non-compliance) with:

- provincial legislation
- guidelines issued by Alberta's superintendent and Canada's superintendent of financial institutions
- federal legislation, such as the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*

[8] *Report of the Auditor General of Alberta—April 2010,* page 100.
[9] http://www.osfi-bsif.gc.ca/
[10] *Report of the Auditor General of Alberta—April 2010*, page 101.

Our audit findings

The department implemented the recommendation by improving its process around monitoring legislative compliance. Specifically, the department:

- obtains an annual confirmation on legislative compliance from ATB and AB Central
- requires ATB and AB Central to provide an action plan to remediate any instances of legislative non-compliance
- follows up on outstanding issues until they are resolved

We tested this process and found it is operating effectively.

Improving transparency—implemented

Background

In 2010, we recommended that the department:[11]

- clearly identify which guidelines and supervisory rules apply to the regulated entities
- develop processes to monitor compliance with the guidelines
- assess how risks are mitigated for those guidelines and supervisory rules that do not apply

Our audit findings

The department implemented the recommendation by advising and obtaining acknowledgement with its regulated entities which guidelines and supervisory rules apply to them and by requiring them to annually confirm their compliance. The results of the compliance confirmations influence the department's risk assessment and supervisory plans for the regulated entities.

[11] *Report of the Auditor General of Alberta—April 2010*, page 102.