



Office of the Superintendent of  
Financial Institutions Canada

Bureau du surintendant des  
institutions financières Canada

# **Office of the Superintendent of Financial Institutions**

## **Legislation and Approvals Division Rule Making – Legislation and Policy Initiatives**

### **Audit & Consulting Services - Management Control Framework Review**

# **REPORT July 2009**



OSFI  
BSIF

Canada

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## 1. Background

The Office of the Superintendent of Financial Institutions Canada's (OSFI) mandate includes promoting "the adoption by management and boards of directors of financial institutions of policies and procedures designed to control and manage risk." OSFI's rule making function supports this aspect of its mandate by contributing to legislative changes, drafting regulations, guidelines and advisories as well as working with various standard-setting agencies (domestic and international) while maintaining a sound balance between prudential requirements and other factors, including due consideration for government policies and objectives, and competition.

Rule making is a key responsibility of the Legislation and Policy Initiatives (LAPI) section that forms part of the Legislative and Approvals Division of the Regulation Sector. In particular, LAPI's rule making objectives are to:

- Contribute to legislative changes and regulation development while maintaining an appropriate balance between prudential requirements and industry competitiveness;
- Develop OSFI rules, guidelines and other types of guidance that are timely, clear, and relevant, that appropriately reflect industry market practices and meet or exceed international minimums using an appropriate consultation process;
- Strike an appropriate balance between contributing to safety and soundness and fostering a competitive environment in which federally regulated financial institutions can succeed;
- Contribute to Canadian and international regulation, standard setting, and rule making;
- Undertake research and policy development work to determine the need for revisions to legislation and guidance, and
- Determine on an ongoing basis, consistent with OSFI's Risk Tolerance Framework, the need for new rules versus the use of other tools to achieve desired goals.

The complexity of the financial industry makes it necessary to consult frequently with applicable stakeholders/specialists within other groups in the Regulation Sector (e.g. Approvals, Actuarial, Accounting, Approvals and Precedents and Capital). For example, rule making can depend on precedents to identify weaknesses in existing rules. Rule making also can rely on subject matter expertise (i.e. Actuarial, Accounting) to identify rules that do not work as intended. These groups have a responsibility to provide input to rule making consistent with their expertise. Those responsible for the rule under development must consider such input.

In general, the difficulty in carrying out rule making relates to:

- The extensive internal and external consultations required often affects timelines;
  - The increasing complexity, rapid pace of innovation, transformation within the industry, professional bodies, and international rules taxes the staff's ability to stay current on industry/market practices and international standards;
  - New issues and urgencies force management to shift priorities and resources; and
  - Corporate memory loss affects the ability to understand the complete history of an issue or its potential relationship to past issues and this can slow down the process.
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## 2. Review Objectives, Scope and Approach

### Objectives

The assurance review objectives are to provide an independent assessment and comment on LAPI's management control framework (framework or LAPI's framework). The review was approved in Audit and Consulting Services Division's (A&CS's) 2008-09 Audit Plan.

The LAPI's framework includes an assessment of the characteristics of these management control elements:

- Management Oversight– the oversight activities and controls embedded in the core process that help ensure the rule making activity is appropriately conducted and meets its objectives. This would generally entail an assessment of the activity's objectives, accountabilities, resource requirements, risk management, monitoring, performance measures, and reporting.
  - Core Process and Control Activities for the rule making activity. Generally, this can be considered a review of policies, procedures, and practices.
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### Scope

The review included an assessment of LAPI's framework for the period April 1, 2007 to March 31, 2008.

Out of scope is an assessment of performance in relation to LAPI's framework, including:

- The degree to which the framework is being applied and consistency in applying the framework from one rule making activity to another; and
  - Whether an informed reader would be able to follow the facts, analysis, and judgements through to the conclusions.
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### Evaluation Criteria and Approach

The review was conducted in accordance with the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing, consistent with the Treasury Board Policy on Internal Audit.

The evaluation criteria (described in **Appendix 1 – Management Control Framework Evaluation Criteria**) set out the elements and related components as a basis for assessing LAPI's framework. These criteria were reviewed and accepted by Regulation Sector's senior management. These criteria are based on internationally recognized *Enterprise Risk Management – Integrated Framework* recommended by the *Committee of Sponsoring Organizations of the Treadway Commission (COSO)* and adapted to OSFI. In applying these evaluation criteria, A&CS looked for existence of the criteria elements and related components and whether they have been operationalized (i.e. formally communicated, documented, and understood).

In order to facilitate A&CS's understanding of LAPI's framework in place we did the following:

- carried out a "walkthrough" of selected rules and documentation to gain an understanding of the framework, and
  - conducted interviews with senior management, managers, and selected LAPI officers.
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### 3. Review Conclusion

*Our conclusion is that Legislation and Policy Initiative's Management Control Framework is satisfactory. Many aspects of the framework are in place incorporating elements and components of a fundamentally sound framework in terms of both the*

- *Management Oversight (Objective Setting, Operational Environment, Risk Management, Information and Communication and Monitoring, Performance Management and Reporting), and*
- *Process and Control Activities (core rule making process and associated policies, procedures and practices).*

*As outlined in this report, there are a number of areas where improvements are needed to formalize the current control processes and practices and clarify expectations to further strengthening the framework.*

A&CS would like to thank all review participants for their cooperation and contribution to this engagement.

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JoAnne Bagnall,  
Senior Director, Audit & Consulting Services

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Date

## 4. Management's Response

The report, its findings and A&CS's observations and recommendations have been reviewed by the Legislation and Policy Initiatives (LAPI) section of the Legislation of Approvals Division. LAPI acknowledges the main themes within the report and generally agrees with its recommendations. The recommendations will assist LAPI in enhancing the efficiency and effectiveness of its operations related to its direct rule making activities and those activities in support of rule making activities undertaken in other areas of Regulation Sector.

The observations and recommendations in the report are divided into seven main areas. Recognizing the existence of some overlap, LAPI will address the recommendations based on the five areas outlined below.

*Operating Environment* - In order to more efficiently and effectively achieve its mandate, LAPI will review and revise its objectives, responsibilities and accountabilities to ensure that they fully reflect all activities performed by LAPI including those not specific to rule making. A review will be conducted of individual responsibilities and accountabilities to ensure that these align with those of the LAPI group overall.

*Risk Management* - LAPI recognizes that a more formal process needs to be implemented to ensure that risk management is integrated into LAPI's day-to-day rule-making work. To facilitate this, LAPI will review its procedures to ensure clarity regarding expectations and accountabilities for risk management decisions and to ensure that all risk assessments and action plans are validated and approved, will provide guidance regarding the Enterprise Risk Management (ERM) process in order to enhance the overall understanding of the risk assessments, and will develop a monitoring process that identifies and prioritizes emerging policy issues identified across OSFI. Given that the risk register templates are being amended to include an approval signature box, the Director, LAPI's signature will be included on its risk register going forward.

*Operational and Resource Management* - Recognizing the uncertainty and complexity of the rule making process and the non cyclical nature of the majority of LAPI's rule making activities, LAPI agrees generally that formal operational planning would reduce risks related to resource allocations. As such, LAPI will develop a formal multi year plan that aligns with its objectives and that addresses ongoing known commitments. This plan must be flexible and will require review on an ongoing basis to reflect unplanned emerging issues and will include monitoring and reporting functions to assess operational performance against approved plans.

*Control Activities and Information Management* - LAPI will incorporate within the Rule Making Framework (RMF) a more clearly defined control structure for rule making activities. Areas for enhancement will include accountabilities to other OSFI frameworks, the need for more formal project planning, the rule making lifecycle, evidence of controls and approvals, and the establishment of criteria when not following standard procedures. With respect to information management, LAPI will investigate ways of ensuring existing systems such as electronic Electronic Data Management System (EDMS) more clearly evidence the rule making process.

*Performance Management and Quality Assurance* - Given the nature of policy development, the establishment of specific service standards can be challenging. However, with respect to the process that it follows under the RMF, LAPI will articulate the standards by which it measures the achievement of its objectives and will assess progress against those standards. It will continue with, and formalize its practice of performing ex-post reviews of guidelines and will also continue to rely, in part, on external surveys to gauge the timeliness and relevance of its rules.

Where possible, and in order to enhance existing systems, LAPI will strive to establish more formal procedures to collect and evaluate performance information regarding compliance with the RMF, OSFI policies, and applicable government policies.

With respect to quality assurance, LAPI will more clearly articulate its policies and procedures in order to provide senior management with assurance that rule making activities meet established standards.

We appreciate the effort taken by A&CS to develop recommendations that will enhance the operations of LAPI.

## 5. Observations and Recommendations

### Overview

The review involved an assessment of the LAPI's framework against evaluation criteria described (**Appendix 1 – Management Control Framework Evaluation Criteria**).

Our detailed observations and recommendations are discussed in this section as follows:

- Objectives Setting
- Operating Environment
- Risk Management
- Operational and Resource Management
- Core Process and Control Activities
- Information and Communications
- Monitoring and Performance Management and Reporting
- Quality Assurance

### Objectives Setting

We found that LAPI's rule making objectives are defined, align with OSFI's corporate objectives, and are well understood.

### Operating Environment

OSFI's rule making responsibilities are centralized within the Regulation Sector. This provides a structure for ensuring consistency and a single voice for communicating rules to all relevant stakeholders. Its organizational structure provides informal and formal mechanisms to enable coordination among various contributors and to support OSFI's matrix organization. It provides a list of subject matter experts for guidance issued, albeit this is not always kept current. It uses working groups and informal meetings to address policy issues and to transfer knowledge. Therefore, we found that LAPI's organization structure enables the achievement of its objectives.

Our review indicated that the LAPI's authorities, responsibilities, and accountabilities specific to rule making are well defined and formally communicated.

In our review of and discussion on LAPI's rule making responsibilities, we found that LAPI's wide range of ongoing other responsibilities and accountabilities are not fully articulated and formally acknowledged. In particular, the staff spends considerable time on other activities that are not specific to rule making although these activities are included in the staff's goal commitment documents against which to assess performance.

For instance, to a lesser or greater extent, managers and officers are expected to:

- Support the Regulation Sector's secretariat and other corporate management activities (i.e. Financial Institutions Supervisory Committee, Canada Deposit Insurance Corporation Board of Directors, committees, ERM, and corporate planning);
- Support other group's rule making activities (Compliance, Actuarial, Capital);
- Support the review and timely posting of newly identified individuals and entities to the OSFI-maintained Terrorist Lists;
- Facilitate knowledge transfer within other areas of OSFI;
- Provide ongoing expert support to interpret rules subsequent to implementation and to respond to internal and external queries (rule implementation);
- Maintain an ongoing monitoring system to identify, evaluate, track and report on emerging risks and significant issues for future policy development consideration, and
- Ensure effective communications with rule and standard setters and external regulatory groups where there are issues of concern to OSFI's objectives and to keep them abreast of

- LAPI's rule making activities through presentations;
- Ensure effective liaison with outside stakeholders (e.g. Department of Finance, Bank of Canada, CDIC) in order to enhance communication flows to and from OSFI with FISC partners and to ensure efficiency by maintaining a single point of entry at OSFI for all enquires.

We noted that these additional ongoing responsibilities use a considerable amount of LAPI's staff time. Thus, an incomplete articulation, acknowledgement and planning for non rule making responsibilities may impede LAPI's ability to efficiently and effectively plan its operational and human resources needs and, as a result, to ultimately achieve its objectives and overall performance expectations.

We also noted that a formal, documented core competencies and training tool for LAPI staff was in place. A *Learning Map* defines the needs for the LAPI's rule making activities. There is also an effort to team individuals to facilitate specialization and knowledge transfer. However, the process for integrating human resource planning (skills, relevant experience, and core competencies) to business needs was not clear. We understand that enhancements to OSFI's ERM framework and corporate business planning processes include improving the process to align business and human resources planning.

## Recommendations

**LAPI should ensure that it fully formalizes, articulates, and communicates its roles, responsibilities, and accountabilities and aligns these with individual's responsibilities.**

## Risk Management

Our objective was to assess the key "characteristics" or design of LAPI's risk management control framework relating to its day-to-day rule-making activities.

In general, we found that LAPI's risk management control framework design is sound and reasonably comprehensive for its rule making activity. However, during the period of review, LAPI's processes were mostly informal. This was partly due to the need to streamline operations and the evolving state of OSFI's risk management's framework and approach.

In particular, we found that LAPI's risk management process is based on OSFI's formalized ERM Framework. Recently, the ERM Framework was updated to reflect a more top-down process and improvements to promote quality, consistency and the ability to address the relative significance of risks across the entire organization. Consequently, some of the observations raised below may be addressed as part of the ongoing improvements.

### *Transparent and demonstrated accountability for business line risk management*

We found that formal roles, responsibilities, and accountabilities are articulated for risk management processes. However, in our walkthrough of the LAPI's risk management activities, we did not clearly evidence formal reviews and sign-offs of risk assessments and action plans at the business line level. In particular, the Director is responsible and accountable for controlling day-to-day operations, including managing LAPI's risks for the rule making activity. Sector senior management is required to formally sign-off on the risk assessment and action plans. These are used as key inputs into the sector and corporate ERM and planning process thereby providing a forum for senior management to challenge and prioritize risks in the context of OSFI's overall strategic objectives and long-term priorities. Furthermore, ERM coordinators assist managers with consolidating and reporting on the risk assessments and action plans.

In our walkthrough of the process, we found that formal risk assessments of key risks are done at the sector level. However, at the business line level the process is largely informal. That is, the ERM Framework states that where a risk is identified as key to a particular business line but not considered "significant" at the sector level, such risks should be discussed and addressed at the business line level.

As well, updating of the business line risk assessments and action plans is done on an annual basis through group discussions within LAPI. Evidence of approval for this process exists (i.e. emails), but was not easily accessible. Due to this informal process, however, we did not clearly evidence the controls to demonstrate accountability for validating and sign-off of the risk assessments and action plans that ultimately support decisions that the residual risks levels for the rule making activity are within the range that management will accept. We note that commencing with OSFI's next comprehensive risk assessment, scheduled for June 2009, the risk report templates have been revised to include the Assistant Superintendent's signature indicating approval of the sector's risk consolidation. Similarly, a signature of the business line owner will be included on all respective business line risk registers.

#### *Clarity and application of risk management metrics*

Based on our review of the LAPI's risk assessments and interviews, we noted that there might be insufficient guidance on and vetting of the ERM Framework's key metrics to ensure that they are appropriately and consistently applied to the risk assessments. For instance, the interpretation, relationship, and application of the OSFI's "risk tolerance" and the ERM Framework "risk tolerance level" were unclear. It is unclear whether the "key existing controls" identified to mitigate the risks actually exist or qualify as key controls. For instance, an identified key existing control was "*Increasing emphasis on principle-based rules*" to mitigate the external environment risks. However, we did not find a formal control process to identify and consistently apply principle-based rules to the rule making activity. Another example is the key control of "*Given the legislation reviews in the next 2 years, resources are available to work on other priorities.*" This is not a control that could be continuously and systematically be applied to address the identified risks to the activity's objectives. A final example is the control of "*Priority planning process and ongoing monitoring consider resources pressures, allows for adjustments to plans where priorities conflict/are unachievable,*" to mitigate people risks; however the process to develop and monitor an integrated human resource and operational plan that includes all of LAPI's activities is mostly informal. Therefore, better guidance on the metrics and control processes to challenge the identification and application of key metrics may enhance the overall understanding and the quality of the risk assessments.

#### *Issue identification, prioritization, assigning and tracking resolution*

Although a key input into LAPI's risk assessment and policy analysis is identification of emerging policy issues, an integrated monitoring process is not formally in place to collect, assess, assign and track resolution to significant issues in a transparent, consistent, and timely manner. Many significant policy issues are raised and informally dealt with within Regulation Sector prior to taking a decision on which rulemaking stream OSFI uses to address the issue (i.e. legislation, regulation, guidance). These issues are often raised through various monitoring processes across OSFI and assigned throughout Regulation and Supervision. Issues are tracked informally and formally if significant. Often, however, where resources need to be redirected, lower priority issues are dropped or held in abeyance until resources are available to advance the issue.

This informal approach to manage policy issues, poses a number of operational challenges. For instance, although it is generally understood that it is essential to have flexibility in the rule making activity due to its inherent complexity and uncertainty, it is often a challenge for staff to allocate time to monitor emerging issues as well as maintain the necessary focus on significant issues and key responsibilities.

As well, the ad hoc manner in which the issues are assigned as significant and prioritized poses operational challenges. Explicit criteria to assess the significance of a policy issue in a consistent and practical manner are lacking. Because it may not be feasible (or necessary) to assess and track all the issues, it is helpful to have criteria to determine the significance and

order in which the issues should be assessed.

For instance, the following criteria may help to assess significance and assign priority of an issue identified through the monitoring process:

- **Relevance** to users and reliability of information that could be provided considering whether the risk or issue is due to a change in market and/or industry practices and is internationally relevant;
- **Pervasiveness and consequence** - whether the issue is one that (a) affects more than a few entities and more than a few jurisdictions, (b) gives rise to problems that are frequent and/or significant (c) will persist if unresolved and may result in suboptimal decisions in the absence of a new or change in policies;
- **Urgency** - whether requests have been received from stakeholders;
- **Availability of existing policy** – e.g. no guidance exists or out-of-date guidance.
- **Materiality and Impact on OSFI’s strategic business objectives and outcomes;** and
- **Resource constraints** - availability of expertise and research required.

Therefore, a more systematic and integrated monitoring process is needed to address policy issues in order to optimize the staff’s ability to properly plan and execute on their key responsibilities in efficient and effective manner.

The above observations indicate that LAPI has a good foundation for risk management, however, a more transparent and rigorous management control process is needed to increase its ability to clearly demonstrate accountability for managing its risks and to achieve objectives related to operational effectiveness.

**Recommendations** LAPI should review its risk management *control* framework (i.e. policies, process and practices) and monitoring process to ensure it:

- **Outlines clear expectations and accountability for risk management decisions by requiring formal validation and sign-offs at the business line level;**
- **Provides adequate and practical guidance on the meaning and application of the key risk management metrics;**
- **Provides for a proper control mechanism for vetting the interpretation and application of the key risk management metrics;**
- **Integrates and develops a formal monitoring process and tools to;**
  - **collect, assess, assign and track resolution of significant policy issues identified from various OSFI-wide monitoring efforts, and**
  - **establish reasonable criteria to enable assessment of the “significance” and priority of policy issues.**

**Operational and Resource Management**

Generally speaking, a key risk for a group such as LAPI is the risk of not having appropriate staff commensurate with the risks identified. This can happen as a result of inadequate policies, process and practices to enable:

- a thorough risk-based assessment and formal planning for the quality and quantity of resources required for the planning period based on operational needs and workforce analysis (i.e. skills, experience, core competencies);
- an allocation of resources consistent with an approved multi-year plan to reflect the longer term timelines for rule making, and
- adequate monitoring and reporting on resource use, type, and quantity.

LAPI uses various approaches to mitigate people risks. We found that ongoing informal resource prioritization and allocation take place through regular meetings with staff and all

levels of management. As a result, there is a general awareness of the operational needs, priorities, and resource constraints. Although priorities and resources are managed within the annually approved budget, it is generally understood that a business case can be made to management when additional resources are needed. Additionally, LAPI mitigates people risks by involving subject matter experts from other areas of OSFI to augment LAPI's people skills.

LAPI maintains a spreadsheet to track about 60 projects that have been allocated to its staff. The majority of the project timelines span more than one year. The project list includes most of LAPI's ongoing rule making responsibilities, but it does not form part of a formal management process that requires a formal approval, assignment of accountabilities and allocation of resources. Also, we noted that LAPI's business plans for the period of review did not articulate all its work activities and resource needs for these projects. These standardized business plans are used as part of the corporate planning process. We were informed that LAPI informally discusses its plans and resources on an ongoing basis. As a result, LAPI's planning process and allocation of resources is fluid due to the ongoing changes in demands and priorities. This is due to the inherent uncertainty and complexity in the rule making activity and, considering that the various events over the past few years have focused OSFI's attention on its ability to respond adequately in a crisis, from a regulatory, prudential, and a human resources perspective.

However, the nature and extent of an informal planning process may create vulnerability for LAPI's ongoing operational management. Management control is effectively designed when management has formal planning activities resulting in a long-term plan that identifies and disseminates accountability and resources for those work activities needed to achieve the objectives and priorities over a reasonable timeframe. To this end, it is a sound management practice for LAPI's planning process to result in a formal, but flexible, multi-year operational plan, which;

- Considers the risks to its objectives and mitigation strategies identified in the ERM process and alignment to corporate strategic objectives;
- Identifies and risk-prioritizes all ongoing work activities for the three-year planning period horizon, considering the lifespan of its projects and interdependencies with other OSFI groups to enhance organizational cohesiveness;
- Includes a workforce plan to address workforce gaps in relation to the operational needs (i.e. skills, specialized experience, resources, etc.);
- Integrates into the corporate planning and budgeting process;
- Is subjected to a constructive challenge, validation, and formal sign-off, and
- Includes a monitoring process to assess performance against plans and to update plans to reflect changes to the risk assessments, business conditions, and priorities.

It is understood that a flexible and dynamic planning process is needed. This is due to the uncertain environment in which LAPI operates that result in the need to continually review and revise the risks and priorities identified in the plans. In this context, improving and formalizing the planning process, developing a multi-year operational plan to address identified risks, and measuring operational performance against the approved plans can optimize operational management effectiveness and efficiencies in the context of a longer-term horizon.

## Recommendations

### **LAPI should:**

- **Formalize its operational planning process by developing a formal, but flexible, multi-year plan that aligns with corporate objectives and long term priorities;**
- **Create planning, project monitoring and reporting tools that are both proactive, and reactive for monitoring, measuring operational performance against approved plans.**

**Core Process and Control Activities**

In August 2008, LAPI formalized its Rule Making Framework (RMF) for its core process. Although this is subsequent to our review period, we were informed that the RMF documents the process and practices in place during the review period. It is expected that the RMF follows a clearly documented process that contains a number of control processes that address the identified risks to the rule-making objectives. The process should evidence the rule making stages, the nature, and extent of consultation, the judgement exercised by the officers, and decisions made by management as the rules are developed and communicated to stakeholders.

The RMF summarizes the rule making control process as follows:

- In determining how OSFI will address a particular issue, the first step is for OSFI to conduct initial policy analysis. This step allows OSFI to gain an understanding of the issue and to establish an appropriate course of action to address it. The assignments are dependent on whether the rule is legislative in nature, a regulation, or a guideline. Where guidance is the recommended course of action, generally the Director, LAPI assigns the development/revision of a rule to a manager or officer within LAPI. A manager within LAPI is responsible for coordinating input to the Department of Finance with respect to legislation development or changes. The Regulation Officer within LAPI spearheads regulations development or changes with input from both internal and external stakeholders as required.
- Throughout the process, consultations occur with those stakeholders that would likely be impacted by the new or revised guideline or by those areas within OSFI that have an interest in the particular issue (e.g. Supervision, Capital, Precedents, and Legal Services). These criteria for determining which internal stakeholders to consult are taken into account at each step of the process where internal input is needed. The Director, LAPI works closely with the person responsible for the project.
- Memoranda prepared for the Assistant Superintendent generally are required to follow a set format. The content, while specific to the issue at hand, is first discussed internally within LAPI before being forwarded outside for comments. The Senior Director, LAPI, and the Assistant Superintendent, Regulation provides comments and sign-off as required.
- The RMF provides further detail on the development process steps and some standard documents for the policy development stream, Initial Policy Analysis and the key rule making streams - regulations, legislation, and guidelines.

In general, we found that the RMF is fundamentally sound incorporating a number of control processes (i.e. policies, procedures and practices). However, there are areas of improvements to formalize the current practices and clarify expectations.

These areas of improvements are as follows:

*Incorporation of responsibilities and accountabilities in the RMF*

- The RMF was not developed to explicitly incorporate relevant responsibilities and accountabilities included in other OSFI management control frameworks. Some of the key ones underpinning the RMF are OSFI's Risk Tolerance Framework, ERM Framework and Policy, Corporate Record Policy, EDMS Business Requirements. As a result, there is a risk that the responsibilities and accountabilities are not clear, inconsistent and not followed when executing the RMF if there is no explicit consideration for these corporate control frameworks as appropriate.

*Incorporation of government rule making process requirements in the RMF*

- The RMF Regulation Development Process does not explicitly and formally consider the implications of the *Cabinet Directive on Streamlining Regulation*. On April 1, 2007, the Canadian Government implemented the *Cabinet Directive on Streamlining Regulation*. The *Directive* introduced a life cycle approach to regulatory management. In particular, departments and agencies are expected to develop a performance measurement and

evaluation strategy and to monitor the implementation of the Directive. They are expected to submit a report to their senior management and Regulatory Affairs on how they have met the commitments and directives and are responsible for abiding by the Directive at all stages of the regulatory lifecycle – development, implementation, evaluation and review. When this policy was being implemented in 2007, LAPI reviewed the implication it had on its regulatory process and decided to defer additional consideration (particularly as it related to measuring, evaluating and reviewing regulations) until an OSFI-sponsored regulation was brought forward. At the time of this review, no OSFI-sponsored regulation had been proposed. Consequentially there is a risk that OSFI-sponsored regulations may be delayed until OSFI has considered the implications of and implemented the additional requirements of the *Cabinet Directive on Streamlining Regulation*.

*Formalizing the policy project planning process*

- A formal project plan is not required prior to commencing rule development work for all rule making streams (i.e. guideline, regulation, legislation). Generally, the plans should include an articulation of the policy development objectives, risks, resources needs, timelines etc. We found, for instance, that for the Guideline Development stream, the process indicates a project plan should be prepared. In practice, this is done for high profile and time sensitive projects only. It may not be necessary to develop project plans for all rule making projects, but a formal control process should be in place to justify not preparing a project plan or the RMF should clearly state the conditions for which a project plan is mandatory for each of policy development streams. Moreover, the RMF could state that when projects are a high priority and/or span significant timeframe, a project plan is mandatory to ensure that the objectives, accountabilities, direction, timelines and resource requirements and allocation are clear, identified and formally agreed to by management. The individual project plans should provide support for LAPI's business and human resources plans, which, in turn, are key inputs into the corporate planning process.

*Adopting a lifecycle approach and control process to rule making*

- The RMF does not fully capture all stages relevant to the rule making lifecycle. Currently, the RMF focuses primarily on the development stage. It lacks reference to implementation, evaluation, and review stages, which would complete the lifecycle. Our review did find evidence that some of the attributes of these other stages are present in the work undertaken by LAPI staff. However, these stages have not been fully identified, documented, and integrated into the RMF's process, thereby potentially resulting in gaps in OSFI's rule making process and an unclear understanding of accountabilities. Adopting a lifecycle approach to rule making is an important step to enhance accountabilities and coordination among groups and to support OSFI's matrix organization. Although this review did not concentrate on cohesiveness, a lifecycle approach would certainly help prevent or mitigate the risks associated with a potential lack of operational cohesiveness.
- The purpose and use of standard documents to support the lifecycle approach to rule making are not fully documented or current. As a result, key decisions, control processes, and accountabilities are not fully articulated in the RMF and/or addressed more broadly within OSFI's rule making as and where appropriate. For example, documents related to a guideline lifecycle are maintained on OSFINet but are not up to date. In addition, the standard GIAS format found on OSFINet that accompanies the release of a guideline has not been consistently applied.

*An appropriate and transparent process to demonstrate accountability for key rules decisions*

- Currently the Guideline Development process implies that the controls are embedded as the policy document makes its way through all stages in the process. However, while in some cases sign-off is evidenced at a control point, the practice is not consistently applied at all stages except when a guideline is being prepared for external distribution (when a transmittal slip evidencing key final approvals is prepared). A key attribute and strength identified by

LAPI officers and senior management is that the RMF needs to and does provide officers and management with sufficient flexibility to recognize the particularities of each rule making project, including the complexity of issues being dealt with, the level of consultation required and time constraints. While such flexibility is desirable in developing guidance, it needs to be underpinned or tempered by appropriate controls. Adequate controls ensure that senior management can place reliance that guidance forwarded to them for approval and release has successfully gone through a transparent due process. Therefore, the RMF should explicitly outline controls at key decision points that key control steps have been attained or where variances in the process have taken place, that management approves these variances.

*An appropriate and transparent consultation process*

- Using an appropriate and transparent consultation process is critical to achieving LAPI's objectives. Consultations undertaken with internal and external stakeholders represent critical steps in policy development. Consultation with financial institutions and subject matter experts are critical activities under *OSFI's Accountability Framework* as well. However, we found that, comments received from external sources are consolidated into a table and their disposition recorded. Internal comments may be subject to this treatment but usually they are contained in the original form in which they were provided (e.g., e-mails) or embedded in the draft document. As a consequence it is more difficult to track internal comments (i.e., determine who may have provided comments, what those comments were, and what their disposition was). Given the internal and external consultation process may involve multiple iterations from the same and different stakeholders, it is important that the substantive comments from internal subject matter experts be summarized and tracked in the same manner as external stakeholder's comments.

**Recommendations**    **LAPI should review its Rule Making Framework to:**

- **Explicitly incorporate relevant responsibilities and accountabilities included in other OSFI management control frameworks;**
- **Address any gaps that may exist between the current process and the *Cabinet Directive on Streamlining Regulation* requirements so that corrective and timely actions can be taken to address implementation issues;**
- **Formalize the control process to clearly state the conditions for which a project plan is mandatory for each of policy streams;**
- **Fully develop the control processes to capture all the stages of the lifecycle for each of the rule making streams, including initial policy analysis, development, implementation, evaluation, and review;**
- **Explicitly outline controls at key decisions points throughout the process for each of the rule making streams. Develop and implement a control checklist that evidences approval that key control steps have been attained or where variances in the process have taken place, that management has approved these variances, and**
- **Enhance its process to ensure there the consultation process is appropriate and transparent.**

**Information and Communication**

Underpinning the day-to-day rule making process is the OSFI-wide electronic data management (EDMS). We found that there is an established EDMS in place to support the rule making decision-making process and corporate records management. This system functions as the corporate memory using a standard electronic file structure based on OSFI's Business Activity Architecture (BAA) and the various policy development phases and streams. As well, the system enables OSFI-wide knowledge sharing. However, the current structure and functionality of the system hinders the retrieval of documents and the understanding as to how, over time, a policy issue was developed and key decisions made along with the supporting rationale. Consequently, it is often difficult to locate key electronic information and documents related to the ultimate development and approval of the key decisions underpinning the final policy documents.

**Recommendations**

**LAPI should review the RMF and information management system to ensure that it substantially and consistently meets its intended purpose, user needs, and explicitly considers the corporate record policies.**

**Monitoring and Performance Management and Reporting**

It is our assessment that there is ongoing and active informal monitoring and reporting on rule making activities. This includes, direct and ongoing senior management oversight over policy development, status and approval.

However, we found that there is no formalized control mechanism in place to periodically assess compliance with the RMF, OSFI's policies and government requirements (*e.g. Government of Canada's Cabinet Directive on Streamlining Regulations*). Without a complete and fully integrated RMF that is subject to periodic assessment, management will not know if the RMF is effective, followed consistently, and aligned with corporate policies and accountabilities.

LAPI's process can be strengthened by formalizing its methodology to collect and evaluate information on service and performance measures and targets. As a part of OSFI's Accountability Framework, LAPI has established formal external performance measures and some targets for rule making. These are used to annually survey industry on their views on OSFI's and LAPI's performance for developing regulations, guidelines, and rules in relation to the objectives. However, LAPI has not fully formalized reasonable service and performance standards process for its key rule making activities that are within its purview of its responsibilities and accountabilities (*e.g. developing versus administering rule making activities*). For example, LAPI does not have an internal formal methodology to systematically collect and evaluate information that would enable monitoring, measuring and reporting on the overall effectiveness in achieving its objectives (*e.g. rules are timely clear, relevant, etc.*)

**Recommendations****LAPI should:**

- **Implement a process to assess periodically compliance with management policies, and**
- **Formalize its methodology to collect and evaluate service and performance information in order to enhance performance management and reporting.**

## Quality Assurance

LAPI is mandated to deliver quality rule making (i.e. timely, relevant, balanced etc.). Quality assurance is a systematic process that should provide senior management with ongoing and reliable assurance that rule making meet minimum quality standards.

In the context of sound quality assurance practices, we expected LAPI's RMF to

- have articulated an expression of quality and communicated it across LAPI and other rule making groups in order to promote a consistent understanding and expectations of quality rule making;
- manage the quality of rule making, by assessing the level of risk / significance and assigning appropriately qualified people who deliver relevant rules in a timely, reliable and balanced manner;
- have a system in place to provide senior management with ongoing and reliable assurance that the entire rule making activities meet established minimum quality standards.

Although there are various formal and informal quality management control practices to oversee the quality and consistency of rule making documents as discussed throughout this report, LAPI has not formally articulated what it means by quality and timely rule-making in the context of its objectives. We found areas that LAPI is doing well; however, improvements are needed to make the quality assurance process more disciplined and transparent.

Ongoing quality assurance is imbedded in the guideline development process by the series of management reviews (next level), internal and external consultations, and control steps that must take place for guidance to make it way to final publication and release. If the next level review is not satisfied with the quality of the work to that point, additional work at that stage or even a previous stage may be required before next level approval is given. Senior management provides ongoing comments throughout the policy development phases and signs-off all policy documents before they are finalized and externally communicated. Where internal consultations produce inconsistent messages, senior directors are expected to mediate and decide on a single/consistent message for their sector. This ongoing quality assurance is implicit in the current rule making process.

However, without an OSFI-wide expression of quality for rule making, it is difficult to have a consistent understanding of quality across LAPI's rule making activities and whether it is delivering rule making that meet its quality expectations. In developing and documenting expression of quality, the following are additional areas that need to be addressed;

- The suite of rule making policy documents needed to support the lifecycle approach and process (e.g. Initial Policy Analysis, Guideline Impact Analysis Statement, Policy Note, Advisory, Consultation Tracking and Disposition, Policy Approval, Transmittal Slip, Post-Implementation Enquires, etc.) is incomplete. Some of these documents have not been included in the RMF or updated to reflect current use. In addition, there is lack of consistent terminology and guidance to explain the purpose and content of the policy documents
- There is no requirement to periodically assess compliance with stated policies, process, and templates provided. Without periodic assessment, management will not know these are effective and followed consistently.
- Methodology and information has not been established to proactively monitor measure and report on the quality of rule making.

## Recommendations

**LAPI should develop / formalize a quality management system to provide senior management with ongoing and reliable assurance that its rule making activities meet established minimum quality standards.** *(Please note that a number of the recommendations identified under the other evaluation criteria have quality assurance components associated with them. To avoid repetition, here we have referenced the recommendation once.)*

## Appendix 1: Management Control Framework Evaluation Criteria

Elements	Components
<b>1. Operating Environment</b>	1.1. Responsibilities, authorities, and the reporting structure are defined. 1.2. Staff competencies, including required formal and informal training necessary to maintain knowledge levels, are defined.
<b>2. Objective Setting</b>	2.1. Objectives for the LAPI function are <ul style="list-style-type: none"> <li>▫ defined</li> <li>▫ align with OSFI's corporate objectives</li> <li>▫ include established application processing service standards</li> <li>▫ are understood</li> </ul> 2.2. Risk tolerances have been established through the ERM process.
<b>3. Risk Management</b>	3.1. Potential inherent risks or events that may impact the achievement of objectives have been : <ul style="list-style-type: none"> <li>▫ Identified</li> <li>▫ Assessed in accordance with OSFI's ERM policy and the established Risk Tolerance</li> <li>▫ Developed mitigation strategies and action plans where control gaps exist.</li> </ul> 3.2. Senior management has communicated its views on the inherent risks and risk mitigation strategies for LAPI.
<b>4. Process and Control Activities</b>	4.1. The process to be followed for LAPI is clearly defined with decision and control points in place that are aligned to identified inherent risks, and include: <ul style="list-style-type: none"> <li>▫ Decision-making guidance and policies where necessary.</li> <li>▫ Appropriate level of analysis, application of judgement and documentation.</li> <li>▫ Professional, service and transparency standards for dealing with the industry.</li> <li>▫ Authorities, escalation and approval/sign-off requirements.</li> <li>▫ Reporting requirements within and outside of LAPI.</li> </ul> 4.2. Quality assurance processes have been built into the LAPI framework to facilitate: <ul style="list-style-type: none"> <li>▫ Monitoring adherence to the LAPI framework</li> <li>▫ Dealing on a timely and effective basis with matters of non- compliance</li> <li>▫ Escalating matters of non-compliance where necessary</li> </ul>
<b>5. Information and Communication</b>	5.1. Information systems appropriately support the LAPI through the provision of timely and accurate information to track and monitor rule making activities. 5.2. A corporate memory is built and maintained through the capture of summary information on decisions made along with supporting rationale 5.3. The policies, practices, and procedures for dealing with rule making are appropriately communicated to rule making staff. 5.4. Staff involved in the rule making process understands how their work relates to the work of others 5.5. Open and timely channels of communication exist among rule making staff and senior management to: <ul style="list-style-type: none"> <li>▫ Ensure appropriate input and consistency of decision making</li> <li>▫ Ensure expectations are communicated.</li> </ul>
<b>6. Monitoring, Performance Management and Reporting</b>	6.1. Ongoing quality assurance activities exist to monitor and report on: <ul style="list-style-type: none"> <li>▫ Adherence to the practices, processes, and performance standards.</li> <li>▫ Rule making activity (volume, complexity etc.) to support planning.</li> <li>▫ Whether rule making areas have been identified and dealt with and whether the resulting decisions have been appropriately described.</li> <li>▫ Areas for process improvement.</li> <li>▫ Overall effectiveness in achieving LAPI's objectives.</li> </ul> 6.2. Appropriate management reporting practices to the Director, Senior Director, and the Assistant Superintendent, Regulation Sector, have been established.