

January 19, 2024

DELIVERED VIA ELECTRONIC MAIL

Office of the Superintendent of Financial Institutions
255 Albert Street, 12th Floor
Ottawa, Ontario K1A 0H2
Email: Consultations@osfi-bsif.gc.ca

Re.: Response to OSFI Consultation on Updating Guideline E-23: Model Risk Management

The Canadian Credit Union Association (CCUA) is pleased to respond to the Office of the Superintendent of Financial Institutions' (OSFI) [consultation](#) on updating Guideline E-23: Model Risk Management (the "Guideline"). The credit union sector welcomes the update and supports efforts to strengthen the effective model risk management of FRFIs.

Background

CCUA is the national trade association that provides services to Canada's 197 credit unions, caisses populaires (outside of Quebec) – including Canada's three federally regulated credit unions – and five regional central organizations (Centrals). Irrespective of whether they are regulated provincial or federally, all credit unions are cooperative financial institutions that exist to serve their members. Unlike banks, which exist to generate profits to increase shareholder value, credit unions generate profits for sustainability and growth reasons, and their primary objective is to meet the financial needs of their members. This focus on service translates into measurable impact for Canadians; since 2004, Canadian credit unions have been chosen annually as the overall winners, among all Canadian financial institutions, in retail banking for Customer Service Excellence at the Ipsos Financial Service Excellence Awards.

The credit union sector, outside Quebec, controls approximately \$301 billion in assets – representing a 6.4 percent share of domestic assets held by all Canadian deposit-taking institutions – and serves more than 6 million Canadians. Credit unions are cooperative financial institutions that operate from 2,214 locations nationwide and are the only financial institutions in 380 Canadian communities. Credit unions support 277,000 small and medium-sized businesses in diverse industries and sectors and are the largest lenders to small and medium-sized businesses at 21% percent market share and 10% of the agricultural lending market. Credit unions are also among the largest lenders to homeowners, representing 16% market share in mortgage lending¹.

Summary

The credit union sector welcomes OSFI's update to the Guideline and supports efforts to strengthen the effective use of Model Risk Management (MRM) by FRFIs.

¹ Credit union lending include \$150 Billion in residential mortgages, \$87 Billion in commercial loan, and \$11 Billion in personal loans.

The sector appreciates that this revised guideline is the natural evolution of MRM due to recent advancements in AI and Machine Learning (ML), which have significantly altered how financial institutions model a broad range of financial and non-financial outcomes.^{2 3} We agree that the adoption of a robust framework with prudent oversight will be critical to ensure that financial institutions prevent exposure to flawed decision making, operational losses, or reputation damage as a result of using AI and ML. In addition, we acknowledge that this is the second round of consultations on this matter, and OSFI has [integrated sector feedback](#) to arrive at this penultimate draft.

We appreciate the principles-based regulation contained in the Guideline, which recognizes that implementation of a FRFI's model risk management should be proportionate to the FRFI as well as the nature and complexity of the predictive model used. In addition, we believe the Guideline's expanded set of principles and outcomes strengthen the risk matrix of financial institutions by ensuring proper risk oversight and flexibility to adapt to increasing technological innovation and integration.

In general, the sector agrees with the proposed draft guidance; however, we offer the following suggestions to either strengthen the guideline or to seek clarification on OSFI's intent:

- *Auditors:* We query the extent that this may create new expectations for auditors.
- *Reporting:* We query OSFI's expectations related to reporting and suggest that expectations be included to align with peer nations.
- *Governance:* We seek clarity on expectations for reporting to the board, which is frequently reference in other OSFI guidance, but omitted here.
- *Management:* We seek clarity on whether management accountabilities should be outlined in the document, as we see in other jurisdictions.

Recommendations

Recommendations on Model Risk Management Framework (s. 5)

5.3 Model risk assessment and reporting

An organization should define metrics to facilitate the transparent and consistent monitoring of model risk at the enterprise level. It should periodically report, at minimum, the following to model owners, users, reviewers, and senior management:

- *Model types*
- *Performance of individual models over their model lifecycle*
- *Description of the operating environment in which models are used*
- *Exceptions from the organization's MRM framework*
- *Enterprise-level assessment of model risk.*

We seek clarity in reference to two elements of model reporting and oversight: audit procedures and self-reporting.

First, models are increasingly important to preparing financial statements, and audit procedures may not necessarily involve a review of the MRM framework. We query to what extent this proposed update might create

² See OSFI's discussion paper [Developing Financial Sector Resilience in a Digital World](#), September 2020.

³ See the following discussion paper: OSFI, [Financial Industry Forum on Artificial Intelligence: A Canadian Perspective on Responsible AI](#), April 2023.

new expectations of auditors that go beyond the requirements of auditing standards and may lead to additional costs for FRFIs.

Second, we seek clarity on OSFI's expectations related to self-reporting (or a self-assessment) of the MRM. We would anticipate that FRFIs would report this information to the prudential authority as part of supervisory activities, similar to a self-assessment.⁴ If this is the case, we suggest that OSFI provide a template self-assessment to ensure uniform reporting across FRFIs and FRPPs.

5.2 Governance and accountability

Principle 5: Organizations have policies, procedures, and governing authorities for each phase of the model lifecycle, where expectations are established based on model complexity and importance.

Principle 6: Organizations recognize the interdependency between data and model risk and have adequate policies and procedures to govern data in models. These policies and procedures should align with the organization's data governance framework and strategy at the enterprise level.

We seek clarity in reference to two elements of model governance and management: reports on model effectiveness and the role of management.

First, we seek clarity on whether reports on model effectiveness, for both internal and external models, should be provided to the internal audit committee to support the guideline's objective of an "enterprise-wide view" of the model's risk. Section 2.3.3.3. of Guideline B-10: *Third-party Risk Management* explicitly references audit reports for third party services, and we suggest that the inclusion of a similar reference in the Guideline may assist with governance of a financial institutions model risk management.⁵

Second, we note that the role of management is largely absent from the Guideline. In contrast, the current version of [E-23 \(issued in 2017\)](#) references the role of senior management to develop and operationalize policies and procedures, a model risk materiality classification, as well as escalation procedures where a model risk committee or senior management can be notified. Similarly, guidelines among peer nations outline the responsibility of senior management to report to the board and for the board to set the MRM risk tolerance to align with the overall risk management framework.⁶ We would anticipate that reporting to the board on the MRM framework would be included in management reports to the risk committee in a similar fashion to the FRFI's Enterprise Risk Management (ERM) framework. While we acknowledge that model risk management goes beyond any role or department, we seek clarity on why the role of senior management is largely omitted from the Guideline.

⁴ Under Principle 2- Governance, the PRA's model risk management guideline states: "Firms have strong governance oversight with a board that promotes an MRM culture from the top through setting clear model risk appetite. The board approves the MRM policy and appoints an accountable individual to assume the responsibility to implement a sound MRM framework that will ensure effective MRM practices." Prudential Regulatory Authority, UK, [CP6/22 – Model risk management principles for banks](#), June 21, 2022.

⁵ In relation to independent audit, section 2.3.3.3. of OSFI's B-10: Third-Party Risk Guideline states: "Service performance and controls are evaluated, and audit rights established, as appropriate. The agreement should give the FRFI and OSFI the right to evaluate the risk management practices related to the service provided. Specifically, the FRFI and OSFI should be able to evaluate the risks arising from the arrangement or appoint independent auditors to evaluate the risk management practices related to service provided and the risks arising from the relationship on the FRFI's or on OSFI's behalf. The FRFI and OSFI should also be able to access audit reports in respect of the service being performed for the FRFI. The FRFI should employ a range of audit and information gathering methods (e.g., independent reports provided by third parties, individually performed or pooled audits)." OSFI, [Guideline B-10: Third-Party Risk](#), p. 14.

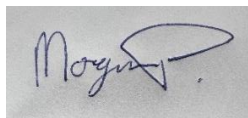
⁶ The Prudential Regulatory Authority (PRA) in the U.K. outlined that financial institutions are required, as part of the Model Risk Management reporting, to have a member senior management report to the board of directors on significant model risk, and that the board should set a firm-wide approach to model risk that is commensurate with its overall risk appetite (Principle 2.1). This may be a function delegated to the risk committee; however, we note that expectations in relation to board oversight are absent from the MRM guideline. Prudential Regulatory Authority, UK, [CP6/22 – Model risk management principles for banks](#), June 21, 2022.

Conclusion

The Canadian credit union sector appreciates the opportunity to participate in OSFI's consultation on updating Guideline E-23, and we welcome the Guideline's focus on advancing model risk management practices in Canada's financial sector.

Please do not hesitate to reach out if you have any questions regarding this submission or if we can provide further information.

Sincerely,

A handwritten signature in blue ink, appearing to read "Morgan Paulgaard", with a stylized flourish at the end.

Morgan Paulgaard
Policy Advisor, National & Federal
Canadian Credit Union Association