Guideline

Delegated Lending Authority

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TABLE OF CONTENTS

INTRODUCTION

The Delegated Lending Authority Guideline outlines expectations for credit unions regarding the practice of delegated lending authority ("DLA")[1] in order to reduce the risk of conflicts of interest and minimize errors and/or fraud related to loan sales and approvals.

BACKGROUND INFORMATION

Many credit unions have a structure whereby their loan origination (sales) staff also possess a DLA as part of their lending operations. This may result in pressure on sales staff to approve credit applications and undermine credit risk management practices. Such a structure potentially creates an inherent conflict of interest when the performance of a DLA holder is incentivized based on sales and growth targets. BC Financial Services Authority ("BCFSA") has observed weak controls around DLA, including a lack of clarity around accountability for DLA and inappropriate segregation of duties, which could potentially lead to conflicts of interest.

REGULATORY EXPECTATIONS

Governance and Accountability

Credit unions should have clearly defined accountability for DLA delegation and sub-delegation. The Board of Directors (the "Board") or Board's Investment and Lending Committee retains ultimate lending authority, in accordance with the credit union's credit authority policy. The Board usually delegates the DLA to the

[1] Delegated lending authority refers to an authority delegated by a credit union's Board of Directors or the Board's Investment and Lending Committee, and often further sub-delegated, which grants an individual the ability to lend funds on behalf of the credit union.

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Chief Risk Officer (“CRO”) or equivalent, and the CRO may then further sub-delegate DLA for operational purposes.

BCFSA expects the CRO to be ultimately accountable for:

- All DLA sub-delegation;
  - Proper segregation of duties (particularly lending approval and sales);
  - Monitoring of DLA; and
  - Performance of all DLA holders.

Having the CRO accountable for sub-delegation is intended to help shape corporate behaviour and aid in strengthening controls for preventing abuse or breach of lending authority.

Segregation of Duties

BCFSA expects that sales staff should be independent of credit approval and oversight functions to avoid any potential conflict of interest. This includes DLA for staff at the executive level. If a credit union finds it necessary to delegate lending authority to sales staff for operational needs, there should be adequate safeguards in place to prevent abuse. Such safeguards could include, for example, include an independent review of credit granted and other internal controls. Retail lending with auto-adjudication may be considered as a form of independent approval for non-exception loans only.

BCFSA expects that DLA holders are able to grant approval for exceptions to credit policy, annual reviews, unauthorized overdraft, and covenant breaches. They should also report to an independent credit risk function. BCFSA expects that credit unions implement minimum controls that are commensurate to their size and complexity.

Individual performance objectives for DLA holders should be linked to the management of risk (e.g., accountable to early delinquency or downgrade of risk ratings) rather than targets related to profit, revenues, and/or volume. Any sales staff with DLA should have their performance appraisal de-linked from sales targets.

BCFSA expects that, if permitted to allow nominal sales as a DLA, a credit union should implement the following key criteria to reduce the potential for conflicts of interest:

- The DLA should be limited to incidental credit increases for existing members;
- The DLA should be limited by dollar amount thresholds; and
- The DLA should be limited to low-risk borrowers (as measured by Beacon, TDS, or another credit risk rating score).

Monitoring

Credit unions should monitor DLA and conduct regular reviews to identify breaches of DLA limits. Credit unions should also monitor DLA to ensure that DLA holders have the appropriate level of knowledge and expertise commensurate with the loan activity for which they are responsible. This monitoring should include a post-approval review. Further, a quality assurance report should be presented to senior management regularly, and management should utilize this report to review/amend individual DLAs to increase, decrease, revoke, or maintain the DLA at least annually.