

# FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO

## NOTICE OF PROPOSED RULE UNDER THE *CREDIT UNIONS AND CAISSES POPULAIRES ACT, 2020*

### Rule 2021 – 002

#### Capital Adequacy Requirements for Credit Unions and Caisses Populaires

June 14, 2021

#### Introduction

The Financial Services Regulatory Authority of Ontario (**FSRA**) is updating its approach to the regulation and supervision of Ontario's credit unions and caisses populaires (**credit unions**) and becoming more transparent, dynamic and flexible. Through the new proposed Rule 2021 – 002, *Capital Adequacy Requirements for Credit Unions and Caisses Populaires* (the **Proposed Rule**) made under the *Credit Unions and Caisses Populaires Act, 2020* (the **CUCPA 2020**) if it comes into force, FSRA's approach to capital adequacy will be more principles-based, proportionate and adaptable to changing circumstances.

Pursuant to subsection 22(1) of the *Financial Services Regulatory Authority of Ontario Act, 2016* (the **FSRA Act**), FSRA is posting the Proposed Rule for comment on its website. The text of the Proposed Rule is set out in Appendix A to this Notice. In accordance with subsection 22(4) of the FSRA Act, interested persons are invited to provide written representations to FSRA with respect to the Proposed Rule within 90 days after the Proposed Rule's publication.

#### Background

FSRA was established under the FSRA Act and, on June 8, 2019, assumed substantially all of the regulatory functions of the Financial Services Commission of Ontario (**FSCO**) and the Deposit Insurance Corporation of Ontario (**DICO**). FSRA is designated as the regulator for the credit union sector pursuant to section 1 of the CUCPA 2020 which defines FSRA as the Authority that regulates credit unions in Ontario and subsection 6(2) of the FSRA Act. In carrying out this role, among others, FSRA provides prudential oversight of Ontario's credit unions' capital adequacy in accordance with legislation, regulations and FSRA's rules and guidance.

Capital adequacy requirements for Ontario credit unions are currently set out in sections 15 to 19 of Ontario Regulation 237/09 (**O. Reg. 237/09**) under the *Credit Unions and Caisses Populaires Act, 1994* (**CUCPA 1994**). In clauses 10 and 11 of subsection 285(1) of the CUCPA 2020, which received Royal Assent on December 8, 2020 and will come into force on proclamation, FSRA is authorized to make a rule "regulating the maintenance, by credit unions, of adequate capital and adequate and appropriate forms of liquidity" and "respecting regulatory capital and the total assets of a credit union".

FSRA intends to make a rule that would require Ontario's credit unions to maintain adequate and appropriate forms of capital. The Proposed Rule would establish requirements for the maintenance of adequate and appropriate forms of capital, and an internal capital adequacy assessment process, which are clear, transparent and more closely aligned with other

jurisdictions' regulatory approach and international standards than the current requirements set out in O. Reg. 237/09.

The Proposed Rule is consistent with the following FSRA priorities, as stated in FSRA's Proposed FY2021-2022 Statement of Priorities:

1. Transitioning to principles-based regulation; and
2. Supporting the modernization of the credit union framework.

The Proposed Rule is also consistent with the following FSRA statutory objects in section 3 of the FSRA Act:

1. To regulate and generally supervise the regulated sectors,
2. To contribute to public confidence in the regulated sectors,
3. To promote and otherwise contribute to the stability of the credit union sector in Ontario with due regard to the need to allow credit unions to compete effectively while taking reasonable risks,
4. To provide insurance against the loss of part or all of deposits with credit unions, and
5. To pursue the objects set out in paragraphs 3 and 4 for the benefit of persons having deposits with credit unions and in such manner as will minimize the exposure of the Deposit Insurance Reserve Fund to loss.

The Proposed Rule will come into force on the later of the day on which clauses 10 and 11 of subsection 285(1) of the CUCPA 2020 are proclaimed into force and 15 days after it is approved by the Minister of Finance.

## **Substance and Purpose of the Proposed Rule**

Under the CUCPA 1994 and O. Reg. 237/09, Ontario's credit unions are subject to capital adequacy requirements based on Basel II standards, established by the Basel Committee on Banking Supervision (**BCSB**) in 2004. In 2010, the BCSB established "Basel III" international standards for capital adequacy of deposit-taking institutions. In November 2017, the Government of Ontario issued a consultation paper entitled "Modernizing Ontario's Credit Union Legislative Framework - Consultation Paper on a Proposed Capital Adequacy Framework". The consultation paper identified the key changes and specific measures that would be necessary to align Ontario's capital adequacy framework more closely with the Basel III framework. Based on this consultation paper and subsequent dialogue between the Ministry of Finance, DICO, FSCO, FSRA and representatives from the credit union sector, modifications to the proposal described in the 2017 consultation paper were discussed, in order to adapt Basel III concepts by making them more relevant and applicable to Ontario's credit unions. Using its rule-making authority under the CUCPA 2020, FSRA seeks to reflect these discussions and update the capital adequacy requirements for Ontario's credit unions in the Proposed Rule.

In the Proposed Rule, FSRA is aligning its regulatory approach with the requirements in other jurisdictions as well as international best practices. The purpose of the Proposed Rule is to

articulate the methodology that credit unions must use to calculate their capital requirements, subject to the Chief Executive Officer's power to grant a variation under section 80 of the CUCPA 2020. The minimum capital requirements are intended to ensure a strong and well-capitalized credit union sector.

## **Summary of the Proposed Rule**

The following provides a high-level summary of each section of the Proposed Rule.

### *Section 1: Interpretation*

This section defines the key terms used in the Proposed Rule and provides direction as to how the Proposed Rule will be interpreted.

### *Section 2: Scope*

This section sets out the scope of the application of the Proposed Rule. It requires that the assets and liabilities of a credit union, its affiliates and its subsidiaries be considered on a consolidated basis, with some exceptions.

### *Section 3: Minimum Capital Ratios, Capital Conservation Buffer Ratio and Leverage Ratio*

This section defines and sets out the values for a credit union's minimum Tier 1 capital ratio, minimum total capital ratio, minimum capital conservation buffer ratio and minimum total supervisory capital ratio. These ratios are expressed as a percentage of a credit union's risk weighted assets determined pursuant to section 6 of the Proposed Rule. The minimum values of the ratios can be found in Table 1.

**Table 1 – Ratios**

Minimum Tier 1 capital ratio	6.5%
Minimum total capital ratio	8.0%
Minimum capital conservation buffer ratio	2.5%
Minimum total supervisory capital ratio	10.5%
Minimum leverage ratio	3.0%

The section also defines the leverage ratio and specifies that the minimum leverage ratio is 3.0 per cent as indicated in Table 1. The minimum Tier 1 capital ratio must include retained earnings of at least 3.0 per cent of a credit union's risk weighted assets, unless the Chief Executive Officer grants a variation under section 80 of the CUCPA 2020. This requirement for minimum retained earnings does not apply to a credit union that has been incorporated for less than 6 years.

### *Section 4: Tier 1 Capital*

This section defines Tier 1 capital and the characteristics required of investment shares for purposes of Tier 1 capital. Tier 1 capital of a credit union predominantly includes investment

shares not redeemable within 12 months and retained earnings. Investment shares are shares of a credit union that must, among other requirements:

- not be redeemable or purchasable for cancellation by the credit union in the first five years after the shares have been issued, except upon the death or expulsion from the credit union of the holder;
- not require the credit union to redeem, purchase or otherwise acquire the shares at a rate of more than 10 per cent of the outstanding shares of that class of shares during any one-year period;
- only be redeemed or purchased for cancellation by the credit union if:
  - the shares are replaced with shares that qualify as Tier 1 capital and are of the same quality or of better quality than the shares they are replacing, and
  - the shares are replaced on conditions that do not use a significant amount of retained earnings, given the income capacity of the credit union; or
  - the credit union can demonstrate to FSRA that the capital of the credit union will be substantially above the credit union's minimum ratios after the shares are redeemed or purchased for cancellation; and
- not contain any right, privilege, restriction or condition that entitles the holder to any payment or distribution by the credit union, including dividends, unless the board declares a dividend.

The section also provides that qualifying shares issued in accordance with O. Reg. 237/09 before the Proposed Rule comes into effect will continue to be Tier 1 capital after the Proposed Rule comes into effect.

#### *Section 5: Tier 2 Capital*

This section defines Tier 2 capital and the characteristics required for securities to be included in Tier 2 capital. Tier 2 capital of a credit union predominantly includes investment shares that are redeemable within 12 months and other securities that qualify as Tier 2 capital. The section specifies that securities that qualified as Tier 2 capital in accordance with O. Reg. 237/09 before the Proposed Rule comes into effect will continue to be Tier 2 capital after the Proposed Rule comes into effect.

#### *Section 6: Risk Weighted Assets*

The section specifies that a credit union's risk weighted assets is the sum of the credit union's credit risk as determined in section 7, operational risk as determined in section 8 and general market – interest rate risk as determined in section 9 of the Proposed Rule.

#### *Section 7: Credit Risk – Standardized Approach*

This section sets out the formula and risk weights for a credit union's asset classes that are used to calculate the amount of a credit union's credit risk using the standardized approach. In particular:

- Deposits held at a credit union central will have a 20% risk weighting, as will deposits at other financial institutions.
- Financial technology investments and local community investments will have a risk weighting of 100% provided that they do not exceed 1% of the credit union's capital.
- Any investment or asset not specified in the Proposed Rule will have a risk weighting of 1250%, unless the Chief Executive Officer specifies a different risk weighting pursuant to section 80 of the Act.

#### *Section 8: Operational Risk – Basic Indicator Approach*

This section sets out the formula and required inputs to calculate the amount of a credit union's operational risk using the basic indicator approach.

#### *Section 9: General Market - Interest Rate Risk*

This section sets out the formula and required inputs to calculate a credit union's general market – interest rate risk. A credit union is also required to establish policies and procedures to manage its exposure to interest rate risks, and prepare and present to the board of the credit union a report at the end of each fiscal quarter describing the credit union's management of its exposure to interest rate risk.

#### *Section 10: Capital Conservation Buffer*

This section requires that a credit union meet or exceed the minimum capital conservation buffer ratio and implement a plan to replenish its capital conservation buffer if its capital conservation buffer ratio falls below the minimum.

The section also requires that a credit union conserve earnings and limit distributions if the credit union's capital conservation buffer falls below the minimum capital conservation buffer ratio. A credit union must conserve more earnings the further below the minimum capital conservation buffer ratio the credit union's capital conservation buffer has fallen.

#### *Section 11: Transition Rule for Minimum Capital Ratios and Capital Conservation Buffer*

This section requires a credit union to apply to the Chief Executive Officer of FSRA for approval of a transition plan if a credit union cannot meet the minimum Tier 1 ratio, the minimum capital conservation buffer ratio or the minimum total supervisory capital ratio when the Proposed Rule comes into force.

#### *Section 12: Leverage Ratio*

This section defines a credit union's leverage ratio to mean a credit union's capital measure expressed as a percentage of the credit union's exposure measure. The section defines the capital measure, and exposure measure and sets out the formulas to calculate their values.

### *Section 13: Internal Capital Adequacy Assessment Process*

This section requires a credit union to establish an internal capital adequacy assessment process and outlines the elements that a credit union must include in this process.

The board and senior management of a credit union with assets of less than \$500 million may determine that the credit union is not required to establish an internal capital adequacy assessment process if appropriate compensating actions are taken and controls are implemented that allow the credit union to appropriately manage its capital risk.

### *Section 14: Failure to Comply with Capital Requirements*

This section states that, if a credit union fails to meet the requirements for adequate capital under section 77 of the CUCPA 2020 or this Proposed Rule, the credit union must:

- not change the terms and conditions of or refinance any loan made by the credit union or make any loan or investment if doing so would adversely impact the capital ratios of the credit union; and
- immediately submit a report to FSRA.

### *Section 15: Coming into Force*

The Proposed Rule will come into force on the later of the day that clauses 10 and 11 of subsection 285(1) of the CUCPA 2020 come into force, and 15 days after it is approved by the Minister of Finance.

### **Authority for the Proposed Rule**

Subsection 10(1) of the *Legislation Act, 2006* provides FSRA with statutory authority to exercise a power conferred by an Act of the Legislature after it receives Royal Assent but prior to it coming into force. Because the *Protect, Support and Recover from COVID-19 Act (Budget Measures), 2020*, c. 36 (the **PRSC-19 Act**) received Royal Assent on December 8, 2020, and Schedule 7 of the PRSC-19 Act contains the CUCPA 2020, which will come into force on proclamation, FSRA is authorized pursuant to clauses 10 and 11 of subsection 285(1) of the CUCPA 2020 to make a rule “regulating the maintenance, by credit unions, of adequate capital and adequate and appropriate forms of liquidity” and “respecting regulatory capital and the total assets of a credit union”.

The following statutory provisions authorize FSRA to make the Proposed Rule:

- Subsection 21(1) of the FSRA Act authorizes FSRA to make rules in respect of any matter over which that Act gives FSRA rule-making authority.
- Clauses 10 and 11 of subsection 285(1) of the CUCPA 2020 authorize FSRA to make a rule “regulating the maintenance, by credit unions, of adequate capital and adequate

and appropriate forms of liquidity” and “respecting regulatory capital and the total assets of a credit union”.

- Section 77 of the CUCPA 2020 requires that a credit union maintain, in relation to its operations, adequate and appropriate forms of capital, and comply with FSRA rules governing adequate capital. Section 77 of the CUCPA 2020, when combined with clauses 10 and 11 of subsection 285(1) of the CUCPA 2020 and subsection 21(1) of the FSRA Act provide FSRA with the authority to require compliance with sections 1 to 8, subsections 9(1) to 9(3), sections 10 to 12 and 14 of the Proposed Rule.
- Section 78 of the CUCPA 2020 requires that a credit union establish capital policies for the credit union consistent with the FSRA rules governing adequate capital, and that the credit union adhere to those policies. Section 78 of the CUCPA 2020, when combined with clauses 10 and 11 of subsection 285(1) of the CUCPA 2020 and subsection 21(1) of the FSRA Act provide FSRA with the authority to require compliance with subsections 9(4) to 9(10) and section 13 of the Proposed Rule.

## **Research and Consultation**

In December 2020, FSRA established a working group comprised of representatives from the credit union sector and the Ministry of Finance, to provide input into the development of the Proposed Rule. Between January and March of 2021, FSRA received input from the working group which reflected the following themes:

- Clarification on risk-weightings of community investments and financial technology investments that would otherwise attract a 1250% risk-weight under Basel III;
- Agreement that transition periods to meet new capital requirements should be flexible and determined on a case-by-case basis; and
- Flexibility for new credit unions in meeting the 3.0 per cent retained earnings requirement.

In addition, FSRA considered capital adequacy frameworks used by other regulators, supervisors and associations in other jurisdictions, including:

- Canada – Office of the Superintendent of Financial Institutions
- British Columbia Financial Services Authority
- Alberta – Credit Union Deposit Guarantee Corporation
- Saskatchewan – Credit Union Deposit Guarantee Corporation
- Manitoba – Deposit Guarantee Corporation
- Québec – Autorité des marchés financiers
- New Brunswick – Credit Union Deposit Insurance Corporation

- Nova Scotia – Credit Union Deposit Insurance Corporation
- Prince Edward Island – Credit Union Deposit Insurance Corporation
- United Kingdom – Prudential Regulation Authority
- Credit Union Prudential Supervisors Association

FSRA has considered the input of the working group and the findings of its research in the development of the Proposed Rule.

### **Unpublished Materials**

FSRA did not rely on any significant unpublished study, report, decision or other written material in making the Proposed Rule.

### **Alternatives Considered**

FSRA considered the following alternatives to developing the Proposed Rule:

1. Issuing principles-based guidance on capital adequacy. Sections 15 to 19 of O. Reg. 237/09 and existing FSRA guidance on capital adequacy are critical components of Ontario's framework for the prudential regulation and supervision of credit unions. Sections 15 to 19 of O. Reg. 237/09 have the force of law under the CUCPA 1994. The Proposed Rule governing capital adequacy requirements must have at least the same degree of prominence and enforceability as sections 15 to 19 of O. Reg. 237/09 and existing FSRA guidance. FSRA guidance alone would lack this degree of prominence and enforceability. For these reasons, FSRA decided to make the Proposed Rule, rather than issuing guidance.
2. Include the contents of sections 15 to 19 of O. Reg. 237/09 in a FSRA rule and maintain existing FSRA guidance on capital adequacy. This would not be consistent with FSRA's intention to enhance the capital requirements for credit unions and align them with Canadian and international standards. This alternative would not have achieved one of FSRA's priorities, namely, to update the regulation of Ontario's credit unions.

### **Anticipated Costs and Benefits**

#### Qualitative Benefits and Costs

Ontario's credit unions will benefit by having capital adequacy requirements that are better aligned with other Canadian and international requirements, thereby increasing the level of confidence in them.

The second qualitative benefit is advancing FSRA's cross-sectoral priority of transitioning to principles-based regulation. The Proposed Rule assists in fulfilling this priority by providing capital adequacy requirements that are based on principles, decreasing FSRA's reliance solely on prescriptive legal requirements.

Elements of the Proposed Rule are principles-based and outcomes focussed. Principles-based regulation ultimately generates a number of beneficial qualitative outcomes for Ontario's credit unions. For example, when implementing its internal capital adequacy assessment process, a credit union will be expressly authorized and encouraged to comply with the Proposed Rule in a manner proportionate to its nature, size, complexity and risk profile. A principles-based framework also facilitates a collaborative regulatory model, whereby Ontario's credit unions work harmoniously with FSRA to achieve desired regulatory outcomes.

An additional qualitative benefit is that the Proposed Rule helps FSRA to achieve its goal of updating Ontario's credit union framework, a sector-specific priority set out in FSRA's 2020-23 Annual Business Plan. In addition, the Proposed Rule will provide transparent, efficient and effective regulation.

The Proposed Rule will also help to ensure that credit unions maintain adequate capital to protect depositors and the Deposit Insurance Reserve Fund from undue risks, while allowing credit unions to remain competitive and meet members' needs.

There are likely to be minimal qualitative costs associated with the Proposed Rule. Credit unions may bear some cost, as they evaluate their capital adequacy in light of the Proposed Rule.

#### Quantitative Benefits and Costs

The requirements outlined in the Proposed Rule will not result in any additional material costs for Ontario's credit unions. Almost all of Ontario's credit unions currently either meet or exceed the requirements specified in the Proposed Rule. As a result, there should be little to no increase in costs for such credit unions in meeting the minimum requirements set out in the Proposed Rule.

#### **Recommendation to the Minister**

FSRA is not proposing to make any recommendations to the Minister of Finance with respect to the amendment or revocation of a regulation or provision in a regulation which relates to the Proposed Rule.

#### **Text of the Proposed Rule**

The full text of the Proposed Rule is contained in Appendix A.

## Questions

- Does the Proposed Rule reflect effective, clear, and appropriate capital adequacy rules for Ontario's credit unions?
- Is there any major topic that should be addressed by the Proposed Rule that is currently not included?
- Is the Proposed Rule sufficiently clear to ensure compliance with its requirements? If not, please specify what is unclear and add clarifying language that should be considered.
- Are there compliance costs that would be associated with the Proposed Rule which FSRA has not considered? If so, please describe and quantify these costs.

## Appendix A - the Proposed Rule

### FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO

#### Rule 2021 – 002

#### Capital Adequacy Requirements for Credit Unions and Caisses Populaires

#### 1. Interpretation

1(1) In this Rule,

- (i) “Act” means the *Credit Unions and Caisses Populaires Act, 2020*;
- (ii) “agricultural loan” has the meaning given to it in **[Ontario regulation xx-xxx (General)]**;
- (iii) “appropriate” in respect of a credit union means appropriate for the structure, size, complexity, risk profile and capital risk exposures of a credit union;
- (iv) “capital conservation buffer ratio” has the meaning given to it in subsection 3(7);
- (v) “capital conservation buffer” has the meaning given to it in subsection 3(6);
- (vi) “CMHC” means the Canada Mortgage Housing Corporation established under the *Canada Mortgage and Housing Corporation Act (Canada)*;
- (vii) “commercial loan” has the meaning given to it in **[Ontario regulation xx-xxx (General)]**;
- (viii) “designated credit rating organization” has the meaning given to it in the *Securities Act*;
- (ix) “financial technology investment” means an investment in an entity that has, as its purpose, the enabling of financial innovation using technology that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services;
- (x) “guarantee” means a guarantee and includes a letter of credit;
- (xi) “insurer” means an insurer licensed under the *Insurance Act*;
- (xii) “internal capital adequacy assessment process” means the internal capital adequacy assessment process specified in section 13;
- (xiii) “leverage ratio” has the meaning given to it in section 12;
- (xiv) “local community investment” means an investment of capital, credit or other funds to an organization that provides essential community products or services such as safe and affordable housing, job opportunities, education, healthcare, financial counselling, and child-care in the communities where members reside;
- (xv) “minimum capital conservation buffer ratio” has the meaning given to it in subsection 3(8);
- (xvi) “minimum leverage ratio” has the meaning given to it in subsection 3(12);

- (xvii) “minimum Tier 1 capital ratio” has the meaning given to it in subsection 3(3);
- (xviii) “minimum total capital ratio” has the meaning given to it in subsection 3(5);
- (xix) “minimum total supervisory capital ratio” has the meaning given to it in subsection 3(10);
- (xx) “other total loss absorbing capacity instrument” means a share, subordinated indebtedness or debt obligation of a financial institution that can be converted, in whole or in part, into a common share or a security that is tier 1 capital of the financial institution or any of its affiliates pursuant to the terms of the instrument or the laws that apply to the financial institution if the regulator of the financial institution makes a public announcement regarding the viability of the financial institution;
- (xxi) “personal loan” has the meaning given to it in **[Ontario regulation xx-xxx (General)]**;
- (xxii) “public sector enterprise” means a municipality or any entity directly and wholly owned by a government, including a school board, hospital, university or social service program that receives, as its primary source of funding, regular financial support from government;
- (xxiii) “regulatory capital” means the sum of Tier 1 capital and Tier 2 capital;
- (xxiv) “residential mortgage loan” has the meaning given to it in **[Ontario regulation xx-xxx (General)]**;
- (xxv) “residential property” has the meaning given to it in **[Ontario regulation xx-xxx (General)]**;
- (xxvi) “risk weighted assets” has the meaning given to it in section 6;
- (xxvii) “senior management” means the following members of management;
  - (a) the chief executive officer of a credit union,
  - (b) individuals who are responsible for the overall management of a material business or function of a credit union, including that of a subsidiary,
  - (c) the heads of the oversight functions of a credit union,
  - (d) other executives who have a functional reporting line directly to the board or chief executive officer of a credit union, and
  - (e) any other individuals that the board of a credit union designates to be part of that credit union’s senior management;
- (xxviii) “stress testing program” means the stress testing policies and procedures specified in paragraph 13(3)(ix);
- (xxix) “Tier 1 capital” has the meaning given to it in subsection 4(1);
- (xxx) “Tier 1 capital ratio” has the meaning given to it in subsection 3(2);
- (xxxi) “Tier 2 capital” has the meaning given to it in subsection 5(1);
- (xxxii) “tier 1 capital of the financial institution” means the tier 1 capital of a financial institution, as determined by the laws that apply to that financial institution;

(xxxiii) “tier 2 capital of a financial institution” means the tier 2 capital of a financial institution, as determined by the laws that apply to that financial institution;

(xxxiv) “total capital ratio” has the meaning given to it in subsection 3(4); and

(xxxv) “total supervisory capital ratio” has the meaning given to it in subsection 3(9).

1(2) In addition to subsection 1(1), if a term or phrase used in this Rule is defined in the Act, that definition shall apply for the purposes of this Rule.

## **2. Scope**

2(1) In this Rule, unless stated otherwise and except as specified by the Chief Executive Officer pursuant to subsection 177(5) of the Act, the amount of an asset or liability is its value as it would appear in the consolidated financial statements of the credit union if the financial statements were prepared as of the date of calculation.

2(2) This Rule applies to every credit union in determining whether it has adequate and appropriate forms of capital, and requires the assets and liabilities of the credit union, its affiliates and its subsidiaries to be considered on a consolidated basis, except for any subsidiary that is,

(i) an insurer; or

(ii) a financial institution, the leverage of which, in the opinion of the Authority, is not appropriate for a credit union.

## **3. Minimum Capital Ratios, Capital Conservation Buffer Ratio and Leverage Ratio**

3(1) In accordance with section 77 of the Act, a credit union must always maintain sufficient capital,

(i) to support the prudent operations of the credit union;

(ii) to support the risk profile of the credit union;

(iii) to align with the credit union’s stress testing program and internal capital adequacy assessment process;

(iv) for the credit union’s Tier 1 capital ratio to be equal to or greater than the minimum Tier 1 capital ratio;

(v) for the credit union’s total capital ratio to be equal to or greater than the minimum total capital ratio;

(vi) for the credit union’s capital conservation buffer ratio to be equal to or greater than the minimum capital conservation buffer ratio;

(vii) for the credit union’s total supervisory capital ratio to be equal to or greater than the minimum total supervisory capital ratio; and

(viii) for the credit union’s leverage ratio to be equal to or greater than the minimum leverage ratio.

3(2) Tier 1 capital ratio means Tier 1 capital expressed as a percentage of risk weighted assets.

- 3(3) Minimum Tier 1 capital ratio means a Tier 1 capital ratio of 6.5 per cent that includes retained earnings equal to or greater than 3.0 per cent of the credit union's risk weighted assets unless,
- (i) the credit union has been incorporated for less than 6 years, or
  - (ii) the Chief Executive Officer has granted a variation from this requirement pursuant to section 80 of the Act.
- 3(4) Total capital ratio means the sum of Tier 1 capital and Tier 2 capital expressed as a percentage of risk weighted assets.
- 3(5) Minimum total capital ratio means a total capital ratio of 8.0 per cent.
- 3(6) Capital conservation buffer means Tier 1 capital in excess of the Tier 1 capital required for a credit union to meet its minimum Tier 1 capital ratio.
- 3(7) Capital conservation buffer ratio means the capital conservation buffer expressed as a percentage of risk weighted assets.
- 3(8) Minimum capital conservation buffer ratio means a capital conservation buffer ratio of 2.5 per cent.
- 3(9) Total supervisory capital ratio means the sum of Tier 1 capital, including the capital conservation buffer, and Tier 2 capital of the credit union, expressed as a percentage of risk weighted assets.
- 3(10) Minimum total supervisory capital ratio means a total supervisory capital ratio of 10.5 per cent.
- 3(11) Leverage ratio means the leverage ratio of a credit union calculated pursuant to section 12.
- 3(12) Minimum leverage ratio means a leverage ratio of 3.0 per cent.
- 3(13) The amount of each minimum requirement contained in paragraphs 3(1)(iv) to 3(1)(viii) and subsections 3(3), 3(5), 3(8), 3(10) and 3(12) is set out in Table 1.

**Table 1 – Ratios**

Minimum Tier 1 capital ratio	6.5%
Minimum total capital ratio	8.0%
Minimum capital conservation buffer ratio	2.5%
Minimum total supervisory capital ratio	10.5%
Minimum leverage ratio	3.0%

#### **4. Tier 1 Capital**

- 4(1) The Tier 1 capital of a credit union is the amount calculated using the formula, A – B.

- 4(2) "A" in the formula in subsection 4(1) is the sum of the following amounts as they would appear in the financial statements of the credit union, if the financial statements were prepared as of the date of the calculation,
- (i) retained earnings;
  - (ii) retained surpluses including contributed surplus;
  - (iii) membership shares;
  - (iv) patronage shares, other than patronage shares that are redeemable within the following 12-month period;
  - (v) investment shares that satisfy the criteria in subsection 4(3) or 4(4), other than investment shares that are redeemable within the following 12-month period; and
  - (vi) accumulated net after tax unrealized loss on available-for-sale equity securities reported in other comprehensive income.
- 4(3) Investment shares for the purposes of paragraph 4(2)(v) are shares, other than membership shares or patronage shares, that must,
- (i) be issued by the credit union;
  - (ii) be paid in full by the holder;
  - (iii) in the event of the insolvency, bankruptcy or winding up of the credit union, be subordinate in right of payment to all subordinated indebtedness, deposits and all other liabilities of the credit union except those that, by their terms, rank equally with or are subordinated to the shares;
  - (iv) be neither secured nor covered by a guarantee of the credit union, a subsidiary or an affiliate of the credit union or by any other arrangement that effectively decreases the share's subordination described in paragraph 4(3)(iii);
  - (v) not require the credit union to redeem or purchase the shares for cancellation;
  - (vi) not be redeemable or purchasable for cancellation by the credit union in the first five years after the shares have been issued, except upon the death or expulsion from the credit union of the holder;
  - (vii) not require the credit union to redeem, purchase or otherwise acquire the shares at a rate of more than 10 per cent of the outstanding shares of that class of shares during any one-year period;
  - (viii) only be redeemed or purchased for cancellation by the credit union if,
    - (a) the shares are replaced with shares that qualify as Tier 1 capital and are of the same quality or of better quality than the shares they are replacing, and
    - (b) the shares are replaced on conditions that do not use a significant amount of retained earnings given the income capacity of the credit union, or
    - (c) the credit union can demonstrate to the Authority that the capital of the credit union will be substantially above the minimum ratios in section 3 after the shares are redeemed or purchased for cancellation;

- (ix) not contain any right, privilege, restriction or condition or be subject to any other arrangement which provides an incentive for the credit union to redeem or purchase the shares for cancellation;
  - (x) not be sold in a way that creates an expectation that the shares will be redeemed or purchased for cancellation by the credit union in the first five years after the shares have been issued, except upon the death or expulsion from the credit union of the holder;
  - (xi) not give holders the right to convert the shares into, or exchange the shares for, shares of any class of shares other than a class of investment shares;
  - (xii) not contain any right, privilege, restriction or condition that entitles the holder to any payment or distribution by the credit union, including dividends unless the board declares, at its discretion, a dividend under subsection 57(1) of the Act;
  - (xiii) not contain any right, privilege, restriction or condition that allows the holder, if the credit union does not make a payment or distribution to the holder,
    - (i) to compel the credit union to redeem or purchase the shares for cancellation, or
    - (ii) to impose any restriction on the credit union other than restricting the right of the board of the credit union to declare dividends or patronage returns on membership shares or patronage shares;
  - (xiv) not contain any right, privilege, restriction or condition related to dividends that depends upon or varies because of the credit rating or financial condition of the credit union; and
  - (xv) not have been purchased,
    - (a) by the credit union or any subsidiary or affiliate of the credit union, or
    - (b) with funding provided directly or indirectly by the credit union.
- 4(4) Shares issued by a credit union prior to this Rule coming into force that were Tier 1 capital of the credit union pursuant to paragraph 5 of the definition of “E” in subsection 17(2) and subsection 17(4) of Ontario Regulation 237/09 are investment shares for the purposes of paragraph 4(2)(v).
- 4(5) “B” in the formula in subsection 4(1) is, subject to subsection 4(6), the sum of the following amounts as they would appear in the financial statements of the credit union, if the financial statements were prepared as of the date of the calculation,
- (i) goodwill;
  - (ii) deferred tax assets, except those arising from temporary differences;
  - (iii) the amount by which identified intangible assets, other than goodwill, that have been purchased directly or acquired in conjunction with or arising from the acquisition of a business, including trademarks, core deposit intangibles, mortgage servicing rights and purchased credit card relationships, exceed 5 per cent of the amount of “A” as determined in subsection 4(2);
  - (iv) any increase in equity capital resulting from securitization transactions;
  - (v) cumulative gains and losses due to changes in the credit union’s credit risk on fair valued financial liabilities;

- (vi) the amount of any defined benefit pension fund that is an asset on the balance sheet of the credit union;
  - (vii) shares of a credit union that have been repurchased but not cancelled by credit union that issued the shares;
  - (viii) investments in any entity that is not consolidated in the financial statements of the credit union;
  - (ix) the amount of a reverse mortgage loan that exceeds a loan to value ratio of 85 per cent;
  - (x) deductions from Tier 2 capital pursuant to subsection 5(3) in excess of the amount of Tier 2 capital pursuant to subsection 5(2);
  - (xi) tier 2 capital of an unconsolidated financial institution held by the credit union;
  - (xii) other total loss absorbing capacity instruments of an unconsolidated financial institution held by the credit union; and
  - (xiii) property of the credit union that is subject to a security interest that is not authorized by the Act.
- 4(6) A credit union may exclude in the calculation of “B”, for the purposes of subsection 4(5), the following assets up to an aggregate amount equal to 1 per cent of the credit union’s Tier 1 capital,
- (i) mortgage servicing rights;
  - (ii) deferred tax assets arising from temporary differences; and
  - (iii) computer software assets included in intangible assets.
- 4(7) For the purposes of subsection 4(5), the following rules apply,
- (i) provisions or allowances for losses of a general nature must be deducted from the most closely applicable class of assets; and
  - (ii) Cash deposits in a financial institution must be offset against overdrafts with the same financial institution.

## **5. Tier 2 Capital**

- 5(1) Tier 2 capital of a credit union is the amount calculated using the formula, C – D.
- 5(2) In subsection 5(1), “C” means the sum of the following amounts as they would appear in the financial statements of the credit union, if the financial statements were prepared as of the date of the calculation,
- (i) a general allowance up to 1.25 per cent of the risk weighted assets of the credit union;
  - (ii) shares issued by the credit union, excluding membership shares, patronage shares and investment shares included in Tier 1 capital, that meet the criteria for inclusion in Tier 2 capital in subsection 5(6);
  - (iii) subordinated indebtedness issued by the credit union that meets the criteria for inclusion in Tier 2 capital in subsection 5(6);

- (iv) other securities issued by the credit union that meet the criteria for inclusion in Tier 2 capital in subsection 5(6) or 5(7) that are not included in Tier 1 capital; and
  - (v) patronage shares that are redeemable within the following 12-month period.
- 5(3) In subsection 5(1), “D” means the sum of the following amounts, as they would appear in the financial statements of the credit union, if the financial statements were prepared as of the date of the calculation;
- (i) accumulated actuarial losses for any defined benefit pension fund liability included on the balance sheet of the credit union where the losses have been accounted for through accumulated other comprehensive income and have not been deducted from retained earnings;
  - (ii) a credit union’s investments in its own securities that are included in Tier 2 capital;
  - (iii) other total loss absorbing capacity instruments of an unconsolidated financial institution owned by the credit union;
  - (iv) a credit union’s investments in Tier 2 capital of an unconsolidated financial institution; and
  - (v) the difference between the total amount of capital required by this Rule, including the additional capital that a credit union determines it should hold pursuant to subparagraph 13(3)(viii)(b), and the amount of regulatory capital that the credit union holds.
- 5(4) If a credit union is required to deduct an amount from its Tier 2 capital pursuant to subsection 5(3) and does not have enough Tier 2 capital to deduct the amount, the shortfall must be deducted from the credit union’s Tier 1 capital.
- 5(5) A credit union must, in its financial statements and for each financial quarter, amortize any security that is included in the credit union’s Tier 2 capital on a straight-line basis in the five years prior to the date on which the security must be redeemed, repaid or purchased by the credit union.
- 5(6) To be included in Tier 2 capital, a share (other than a membership share, patronage share or investment share included in Tier 1 capital), subordinated indebtedness, or any other security, must,
- (i) be issued by the credit union;
  - (ii) be paid in full by the holder;
  - (iii) provide that the security will, in the event of the insolvency or winding up of the credit union, be subordinate in right of payment to all deposit liabilities of the credit union and all other liabilities of the credit union except those that, by their terms, rank equally with or are subordinate to the security;
  - (iv) be neither secured nor covered by a guarantee of the credit union, a subsidiary or an affiliate of the credit union or by any other arrangement that effectively decreases the security’s subordination described in paragraph 5(6)(iii);
  - (v) not be redeemable or impose an obligation on the credit union to purchase the security for cancellation in the first five years after it is issued;

- (vi) not be convertible into or exchangeable for a security other than a security that is also Tier 2 capital;
  - (vii) not contain any right, privilege, restriction or condition or be subject to any other arrangement which provides an incentive for the credit union to redeem or purchase the security for cancellation;
  - (viii) only be redeemed, or purchased for cancellation by the credit union if,
    - (a) it is replaced with a security that qualifies as Tier 1 capital or Tier 2 capital that is of the same quality or of better quality than the security it is replacing, and
    - (b) it is replaced on conditions which do not use a significant amount of retained earnings, given the income capacity of the credit union, or
    - (c) the credit union can demonstrate to the Authority that the capital of the credit union will be substantially above the requirements of section 3 after the security is redeemed or purchased for cancellation;
  - (ix) not be sold in a way which creates an expectation that the security will be redeemed or purchased by the credit union in the first five years after it is issued;
  - (x) not contain any right, privilege, restriction, or condition that accelerates the payment of any amount to the security holder except if the credit union is wound-up or dissolved;
  - (xi) not contain any right, privilege, restriction, or condition to or related to dividends or interest that depends upon or varies because of the credit rating or financial condition of the credit union; and
  - (xii) not have been purchased,
    - (a) by the credit union or any subsidiary or affiliate of the credit union, or
    - (b) with funding provided directly or indirectly by the credit union.
- 5(7) Securities issued by a credit union prior to this Rule coming into force that were Tier 2 capital of the credit union under Ontario Regulation 09/237 are securities that are eligible as Tier 2 capital pursuant to paragraph 5(2)(iv) of this Rule.

## **6. Risk Weighted Assets**

- 6(1) The amount of a credit union's risk weighted assets is the amount calculated using the formula,  $A + B + C$ .
- 6(2) In subsection 6(1), "A" means the amount of the credit union's credit risk using the standardized approach as determined in section 7.
- 6(3) In subsection 6(1), "B" means the amount of the credit union's operational risk using the basic indicator approach, as determined in section 8.
- 6(4) In subsection 6(1), "C" means the amount of the credit union's general market - interest rate risk, as determined in section 9.

## **7. Credit Risk – Standardized Approach**

- 7(1) The amount of the credit union's credit risk is the sum of the credit union's individual credit risks.

- 7(2) An individual credit risk means the amount of an asset of the credit union specified in column one of Table 2, multiplied by the corresponding risk weighting in column two of Table 2.

**Table 2 - Asset Risk Weightings**

Asset Class	Risk Weighting
<ul style="list-style-type: none"> <li>a) Cash.</li> <li>b) Claims against, or guaranteed by, the Government of Canada or an agency of the Government.</li> <li>c) Claims against, or guaranteed by, the government of the province of Ontario.</li> <li>d) Claims against, or guaranteed by, the government of a province or territory of Canada other than the province of Ontario with a credit rating from a designated credit rating organization of AAA to A.</li> <li>e) Claims fully secured by collateral consisting of cash or securities issued by the Government of Canada or the government of the province of Ontario or a province or territory of Canada with a credit rating from a designated credit rating organization of AAA to A.</li> <li>f) Residential mortgage loans that are insured under the <i>National Housing Act</i> (Canada), or guaranteed or insured by a government agency.</li> <li>g) The portion of a residential mortgage loan that is insured by an insurer licensed to undertake mortgage insurance, to the extent that the benefits payable under the policy insuring the loan have a backstop guarantee provided by the Government of Canada.</li> <li>h) Mortgage-backed securities that are guaranteed by the Canada Mortgage and Housing Corporation and secured against residential mortgage loans.</li> <li>i) Investments in corporate entities that are accounted for in the credit union's financial statements using the equity method.</li> <li>j) Any amount specified in subsection 4(4), 4(5) or 5(3).</li> <li>k) Claims against the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Community, European Stability Mechanism and the European Financial Stability Facility.</li> <li>l) Claims against a sovereign or its central bank with a credit rating from a designated credit rating organization of AAA to AA- other than a claim described in paragraphs b) to h), o) or ee).</li> <li>m) Claims against a multilateral development bank specified in subsection 7(4).</li> </ul>	0%
<ul style="list-style-type: none"> <li>n) Cheques and other items in transit.</li> <li>o) Claims against or guaranteed by the government of a province or territory of Canada, other than the province of Ontario, with a credit rating from a designated credit rating organization of A- to BBB.</li> <li>p) Claims against or guaranteed by a municipality in Ontario.</li> <li>q) Claims against or guaranteed by a municipality in a province or territory of Canada, other than the province of Ontario, with a credit rating from a designated credit rating organization of AAA to A.</li> </ul>	20%

<ul style="list-style-type: none"> <li>r) Claims against or guaranteed by a school board, college, university, hospital, or social service provider that receives, as its primary source of funding, regular financial support from the government of the province of Ontario.</li> <li>s) Claims against or guaranteed by a school board, college, university, hospital, or social service provider in Canada that receives, as its primary source of funding, regular financial support from the government of a province or territory of Canada, other than the government of the province of Ontario, with a credit rating from a designated credit rating organization of AAA to A.</li> <li>t) Deposits in a bank or authorized foreign bank within the meaning of section 2 of the <i>Bank Act</i> (Canada), a corporation registered under the <i>Loan and Trust Corporations Act</i> or a corporation to which the <i>Trust and Loan Companies Act</i> (Canada) or similar legislation of another province or territory of Canada applies.</li> <li>u) Commercial paper, bankers' acceptances, bankers' demand notes and similar instruments guaranteed by a bank or authorized foreign bank within the meaning of section 2 of the <i>Bank Act</i> (Canada), a corporation registered under the <i>Loan and Trust Corporations Act</i> or a corporation to which the <i>Trust and Loan Companies Act</i> (Canada) or similar legislation of another province or territory of Canada applies.</li> <li>v) Deposits in a central, Central 1 Credit Union, Fédération des caisses Desjardins du Québec.</li> <li>w) Interest rate contracts, including any current exposure and any potential future exposure on such contracts, with a central, Central 1 Credit Union, Fédération des caisses Desjardins du Québec, a financial institution, credit union or another equivalent entity approved in writing by the Authority.</li> <li>x) Claims against a sovereign or its central bank with a credit rating from a designated credit rating organization of A+ to A- other than a claim described in paragraphs b) to h), o) or ee).</li> <li>y) Claims against any public sector enterprise whose sovereign has a credit rating from a designated credit rating organization of AAA to AA- other than a claim described in paragraphs p) to s), ff) and gg).</li> <li>z) Claims against a multilateral development bank with a credit rating from a designated credit rating organization of AAA to AA-.</li> <li>aa) The value attributed to any off-balance sheet exposure relating to assets of the credit union listed in paragraphs r) to w), as calculated in accordance with Table 3.</li> </ul>	
<ul style="list-style-type: none"> <li>bb) Residential mortgage loans where the amount of the loan, together with the amount then outstanding of any mortgage having an equal or prior claim against the residential property, does not exceed 80 per cent of the value of the property when the loan is made, provided that the residential mortgage loans are not 90 days or more past due.</li> <li>cc) Mortgage-backed securities that are fully and specifically secured by residential mortgage loans, other than mortgage-backed securities described in paragraph h).</li> </ul>	35%

<p>dd) The value attributed to any off-balance sheet exposure relating to assets of the credit union listed in paragraphs bb) and cc), as calculated in accordance with Table 3.</p>	
<p>ee) Claims against or guaranteed by, the government of province or territory of Canada, other than the province of Ontario, with a credit rating from a designated credit rating organization of BBB- or less that is not in default.</p> <p>ff) Claims against or guaranteed by a municipality in a province or territory of Canada, other than the province of Ontario, with a credit rating from a designated credit rating organization of A- or less that is not in default.</p> <p>gg) Claims against or guaranteed by a school board, college, university, hospital, or social service provider in Canada that receives, as its primary source of funding, regular financial support from the government of a province or territory of Canada, other than the government of the province of Ontario, with a credit rating from a designated credit rating organization of A- or less that is not in default.</p> <p>hh) Claims against a sovereign or its central bank with a credit rating from a designated credit rating organization of BBB+ to BBB- other than a claim described in paragraphs b) to h), o) or ee).</p> <p>ii) Claims against any public sector enterprise whose sovereign has a credit rating from a designated credit rating organization A+ to A- other than a claim described in paragraphs p) to s), ff) and gg).</p> <p>jj) Claims against a multilateral development bank with a credit rating from a designated credit rating organization of A+ to BBB- or that is not rated by a designated credit rating organization.</p>	<p>50%</p>
<p>kk) Personal loans.</p> <p>ll) Agricultural loans.</p> <p>mm) Commercial loans made to a person where the sum of all commercial loans made to that person and to any connected persons does not exceed the lesser of 0.035 per cent of the credit union's total assets and \$1.25 million.</p> <p>nn) The value attributed to any off-balance sheet exposure relating to assets of the credit union listed in paragraphs kk) to mm), as calculated in accordance with Table 3.</p>	<p>75%</p>
<p>oo) Commercial loans, other than commercial loans described in paragraph mm) where the borrower does not have a credit rating prescribed in Table 4.</p> <p>pp) Residential mortgage loans described in bb) that are 90 days or more past due.</p> <p>qq) The portion of a residential mortgage loan insured by an insurer licensed to undertake mortgage insurance that does not have a backstop guarantee provided by the Government of Canada if the insurer does not have a credit rating.</p> <p>rr) Claims against a sovereign or its central bank with a credit rating from a designated credit rating organization of BB+ to B- or that is not rated by a designated credit rating organization other than a claim described in paragraphs b) to h), o) or ee).</p>	<p>100%</p>

<p>ss) Claims against any public sector enterprise whose sovereign has a credit rating from a designated credit rating organization of BBB+ to B- or that is not rated by a designated credit rating organization other than a claim described in paragraphs p) to s), ff) and gg).</p> <p>tt) Claims against a multilateral development bank with a credit rating from a designated credit rating organization of BB+ to B-.</p> <p>uu) The value attributed to any off-balance sheet exposure relating to assets of the credit union listed in paragraphs oo) to qq), as calculated in accordance with Table 3.</p> <p>vv) Financial technology investments and local community investments up to an aggregate maximum of 1 per cent of the credit union's capital in the credit union's financial statements.</p>	
<p>ww) Claims against a sovereign or its central bank with a credit rating from a designated credit rating organization below B- other than a claim described in paragraphs b) to h), o) or ee).</p> <p>xx) Claims against any public sector enterprise whose sovereign has a credit rating from a designated credit rating organization below B- other than a claim described in paragraphs p) to s), ff) and gg).</p> <p>yy) Claims against a multilateral development bank with a credit rating from a designated credit rating organization below B-.</p>	150%
<p>zz) Investments in entities, or assets generated by business activities not otherwise included in Table 2.</p> <p>aaa) Unrated retained securitization exposures except for (i) the most senior exposure in a securitization, (ii) exposures that are in a second loss position or better in asset-backed commercial paper programs; and (iii) eligible liquidity facilities.</p>	1250%
<p>bbb) Commercial loans described in paragraph oo) if the borrower has a credit rating specified in Table 4.</p>	The percentage determined in accordance with Table 4, subsections 7(7) and 7(8).
<p>ccc) The portion of a residential mortgage loan described in paragraph g) that does not have a backstop guarantee provided by the Government of Canada but is insured by an insurer with a credit rating specified in Table 4.</p>	The percentage determined in accordance with Table 4, subsections 7(7) and 7(8).

- 7(3) The Chief Executive Officer may, pursuant to section 80 of the Act, specify a risk weighting for investments in entities, or assets generated by business activities not otherwise included in Table 2 that differs from the risk weighting specified in paragraph zz) of Table 2.
- 7(4) The following multilateral development banks have a risk weighting of 0 per cent in Table 2,
- (i) International Bank for Reconstruction and Development;
  - (ii) International Finance Corporation;
  - (iii) Asian Development Bank;
  - (iv) African Development Bank;
  - (v) European Bank for Reconstruction and Development;
  - (vi) Inter-American Development Bank;
  - (vii) European Investment Bank;
  - (viii) European Investment Fund;
  - (ix) Nordic Investment Bank;
  - (x) Caribbean Development Bank;
  - (xi) Islamic Development Bank;
  - (xii) Council of Europe Development Bank;
  - (xiii) Multilateral Investment Guarantee Agency;
  - (xiv) International Development Agency; and
  - (xv) International Finance Facility for Immunisation.
- 7(5) To determine the value attributed to any off-balance sheet exposure relating to assets of a credit union listed in paragraphs r) to w), bb), cc), kk) to mm) and oo) to qq) in Table 2, the credit union must, for each off-balance sheet exposure listed in column one of Table 3, multiply the face amount or notional principal amount of the off-balance sheet exposure by the corresponding conversion factor in column two of Table 3.

**Table 3 - Off-Balance Sheet Exposures**

Off-balance sheet exposure	Conversion Factor
<ul style="list-style-type: none"> <li>a) Direct credit substitutes.</li> <li>b) Acquisitions of risk participation in bankers' acceptances and participation in direct credit substitutes (for example, standby letters of credit).</li> <li>c) Sale and repurchase agreements.</li> <li>d) Forward asset purchases.</li> </ul>	100%
<ul style="list-style-type: none"> <li>e) Transaction-related contingencies.</li> <li>f) Commitments with an original maturity exceeding one year, including underwriting commitments and commercial credit lines.</li> </ul>	

g) Open-ended commitments that are cancellable by the credit union at any time subject to a notice period.	50%
h) Trade-related contingencies. i) Commitments with an original maturity of one year or less.	20%
j) Commitments that are legally and practically unconditionally cancellable at any time by the credit union without prior notice or that effectively provide for automatic cancellation due to deterioration in the borrower's creditworthiness. This includes undated or open-ended commitments, such as unused credit card lines, personal lines of credit, and overdraft protection for personal chequing accounts that are legally and practically unconditionally cancellable at any time.	0%

7(6) In section 7, including Table 2 and Table 3 and in section 12,

- (i) "commitment" means an obligation of a credit union, whether or not it contains a material adverse change clause or a similar clause, and includes an obligation in a written contract or agreement with a commitment fee or some other form of consideration to fund a counterparty in the normal course of business should the member seek to draw down the commitment;
- (ii) when determining the maturity of a commitment, the term is measured from the date when the commitment is accepted by the counterparty until the earliest date on which the commitment is scheduled to expire or the credit union can, at its option, legally and practically unconditionally cancel the commitment;
- (iii) "direct credit substitutes" include,
  - (a) guarantees or equivalent instruments backing financial claims where the risk of loss to the credit union is directly dependent on the creditworthiness of the counterparty,
  - (b) guarantees or obligations of a member, and
  - (c) guarantees given by the credit union on behalf of a member to satisfy the member's financial obligations should the member fail to do so, such as payment for existing indebtedness for services, payment with respect to a purchase agreement, lease, loan or mortgage payments, payment of uncertified cheques, remittance of tax to the government, payment of existing indebtedness for merchandise purchased, payment of an unfunded pension liability, reinsurance of financial obligations, standby letters of credit or other equivalent irrevocable obligations serving as financial guarantees for, or supporting, loans and securities, risk participation in bankers' acceptances and risk participation in financial letters of credit;
- (iv) "forward asset purchase" means a commitment to purchase a loan, security, or other asset at a specified future date, usually on prearranged terms, and includes financing facilities with certain draw-down;

- (v) “risk participation” means an agreement or arrangement whereby guarantees made by participating credit unions provide that if there is a default by the underlying obligor, the other credit unions will indemnify the selling credit union for the full principal and interest attributable to it under the agreement or arrangement;
  - (vi) “trade-related contingencies” include short-term, self-liquidating, trade-related items such as commercial and documentary letters of credit issued by the credit union that are, or are to be, collateralized by the underlying shipment, and specifically: (a) include letters of credit issued on behalf of a counterparty with letters of credit of which the counterparty is a beneficiary, and (b) exclude letters of credit advised by the credit union for which the credit union is acting as reimbursement agent; and
  - (vii) “transaction-related contingencies” include bid bonds, performance bonds, warranties, standby letters of credit related to a particular transaction and any other contingencies that relate to the ongoing business activities of a counterparty, where the risk of loss to the credit union depends on the likelihood of a future event that is independent of the creditworthiness of the counterparty.
- 7(7) To determine the value of an asset described in paragraphs bbb) or ccc) of Table 2, the credit union must multiply the value of the asset by the risk weight in column one of the row containing the credit rating of the borrower in column two, three or four of Table 4.
- 7(8) If a borrower is rated by more than one designated credit rating organization specified in Table 4, the credit union must use the highest risk weight generated by Table 4.
- 7(9) A credit union, if it provides prior notice to the Authority in writing, may use a designated credit rating organization not specified in Table 4 and the equivalent ratings for the designated credit rating organization the credit union has selected will be deemed to be included in the ratings contained in columns 2, 3 and 4 of rows 2, 3, 4 and 5 of Table 4 and in all other references to a credit rating from a designated credit rating organization in this Rule.

**Table 4 - Credit Ratings Table**

Risk Weight	Designated Credit Rating Organizations		
	DBRS	S&P/FITCH	Moody's
20%	AAA to AA (low)	AAA to AA -	Aaa to Aa3
50%	A(high) to A (low)	A+ to A-	A1 to A3
100%	BBB (high) to B (low)	BBB+ to B-	Ba1 to B3
150%	Below B (low)	Below B-	Below B3

## 8. Operational Risk – Basic Indicator Approach

- 8(1) A credit union's operational risk, referred to as "B" in subsection 6(1), is the amount calculated using the formula,  $D / 0.08$ .
- 8(2) In subsection 8(1), "D" is the amount of the credit union's capital charge for operational risk as determined under subsection 8(3).
- 8(3) A credit union's capital charge for operational risk is the amount calculated using the formula,  $0.15 \times (E + F + G) / H$ .
- 8(4) In subsection 8(3), "E" is the greater of
- (i) the amount of the credit union's interest income less its interest expenses for its most recently ended financial year, plus its other non-interest income and fees received for outsourcing services for its most recently ended financial year, but specifically excluding,
    - (a) any provisions,
    - (b) operating expenses, including fees paid to outsourcing service providers,
    - (c) realized profits or losses from the sale of securities held by the credit union and classified as "held to maturity" and "available for sale", and
    - (d) extraordinary or irregular items; and
  - (ii) zero.
- 8(5) In subsection 8(3), "F" is the amount that would be determined under the definition of "E" if that definition applied to the credit union's second most recently ended financial year.
- 8(6) In subsection 8(3), "G" is the amount that would be determined under the definition of "E" if that definition applied to the credit union's third most recently ended financial year.
- 8(7) In subsection 8(3), "H" is the greater of,
- (i) the number of years in which the amounts determined under the definitions of "E", "F" and "G" exceed zero, and
  - (ii) one.

## 9. General Market - Interest Rate Risk

- 9(1) A credit union's general market - interest rate risk, referred to as "C" in subsection 6(1), is its risk calculated using the formula,  $(K \times 0.15) / 0.08$ .
- 9(2) In subsection 9(1), "K" means the amount of the credit union's exposure to interest rate risk, determined in accordance with the techniques required in paragraph 9(4)(ii).
- 9(3) A credit union's exposure to interest rate risk means the potential negative impact, expressed in Canadian dollars, of changes in interest rates on a credit union's earnings and net asset values when the dates of its payments of principal and interest and its receipts of principal and interest are not matched.
- 9(4) Every credit union must establish, for the purposes of managing its exposure to interest rate risk, policies and procedures that include,

- (i) clear and prudent limits on the credit union's exposure to interest rate risk and on the impact of this exposure on the net interest income and surplus of the credit union which consider fluctuations in interest rates that the credit union reasonably expects to occur;
  - (ii) techniques to be used to calculate the amount of the credit union's exposure to interest rate risk;
  - (iii) internal controls to be implemented to ensure compliance with the interest rate policies and procedures;
  - (iv) corrective action that the credit union will take if the limits on the credit union's exposure to interest rate risk are exceeded; and
  - (v) content and frequency of reports to the board and senior management of the credit union about the management of the credit union's exposure to interest rate risk.
- 9(5) The policies and procedures required in subsection 9(4) must be approved by the board of the credit union.
- 9(6) The policies and procedures of the credit union established pursuant to subsection 9(4) must require that the credit union submit a written report to its board and the Authority if the credit union's exposure to interest rate risk exceeds the limits established pursuant to paragraph 9(4)(i). The report must be submitted within 21 days after the credit union's exposure to interest rate risk exceeds the limits established pursuant to paragraph 9(4)(i).
- 9(7) The report required by subsection 9(6) must,
- (i) describe the circumstances that led to the credit union's exposure to interest rate risk exceeding the limits;
  - (ii) describe the effect that this exposure has had, and may have, on net income;
  - (iii) describe the steps taken to bring this exposure within the limits; and
  - (iv) include a schedule indicating when the credit union will comply with its policies and procedures.
- 9(8) If a credit union's exposure to interest rate risk exceeds the limits established in its policies and procedures adopted pursuant to paragraph 9(4)(i), the credit union must immediately bring its exposure within those limits.
- 9(9) If a credit union's exposure to interest rate risk exceeds the limits established in its policies and procedures pursuant to paragraph 9(4)(i) for two consecutive quarters, the credit union must promptly submit to the Authority a plan approved by the board of the credit union that describes how the credit union will bring its exposure to interest rate risk within the limits established pursuant to paragraph 9(4)(i).
- 9(10) A credit union must prepare a report at the end of each quarter of its fiscal year describing the credit union's management of its exposure to interest rate risk. The report must include all information about the management of interest rate risk that the credit union has filed with the Authority in that quarter. The credit union must present the report at a meeting of the board of the credit union within 60 days after the end of the quarter for which the report is prepared.

9(11) A credit union must integrate the policies and procedures it establishes pursuant to subsection 9(4) into the credit union’s internal capital adequacy assessment process pursuant to section 13.

**10. Capital Conservation Buffer**

- 10(1) If a credit union’s capital conservation buffer ratio is below the minimum capital conservation buffer ratio, the credit union must immediately implement a plan to meet or exceed the minimum capital conservation buffer ratio, and such plan must include,
- (i) the strategy the credit union will use to complete the plan;
  - (ii) the timeframe for the plan; and
  - (iii) if the credit union expects to complete the plan promptly, assurances that the capital conservation buffer ratio recovery is not temporary.
- 10(2) The credit union must promptly provide the plan described in subsection 10(1) to its board and to the Authority.
- 10(3) In each of its financial quarters, a credit union must not make any distribution that would cause the credit union to retain less than the percentage of the credit union’s earnings for its previous financial quarter specified in Table 5 at the intersection of,
- (i) the row of Table 5 that contains the range of percentage values that includes the percentage determined by expressing the credit union’s capital conservation buffer as a percentage of the capital conservation buffer required for the credit union to comply with the minimum capital conservation buffer ratio; and
  - (ii) column two of Table 5.

**Table 5 – Capital Conservation Buffer**

Capital conservation buffer as a percentage of the capital conservation buffer required for a credit union to comply with the minimum capital conservation buffer ratio.	Percentage of credit union earnings for previous financial quarter that the credit union must retain.
< 75%	100%
≥75% to 85%	80%
≥85% to 90%	60%
≥90% to 100%	40%
≥100%	0%

- 10(4) In section 10 of this Rule,
- (i) “distributions” includes dividends, share buybacks, discretionary payments on Tier 1 securities, discretionary bonus payments to employees, directors, officers and

contractors of the credit union, its subsidiaries and affiliates, and other discretionary payments, but excludes payments that do not result in a reduction of Tier 1 capital such as non-cash dividends paid on membership shares; and

- (ii) “earnings” means distributable profits calculated prior to the deduction of distributions and after the tax which would have been reported if the credit union had not made distributions.

## **11. Transition Rule for Minimum Capital Ratios and Capital Conservation Buffer**

- 11(1) If, on the date that this Rule comes into force, a credit union cannot meet the minimum Tier 1 capital ratio, the minimum capital conservation buffer ratio or the minimum total supervisory capital ratio, the credit union must apply to the Chief Executive Officer for approval of a transition plan to relieve the credit union from complying with its obligations to maintain the minimum Tier 1 capital ratio, the minimum capital conservation buffer ratio or the minimum total supervisory capital ratio or any combination of the these ratios, as provided in the transition plan and subject to the terms of the transition plan.
- 11(2) An application under subsection 11(1) must be in a form approved by the Chief Executive Officer and must describe how and when the credit union will meet the requirements to maintain the minimum Tier 1 capital ratio, minimum capital conservation buffer ratio and minimum total supervisory capital ratio.
- 11(3) The Chief Executive Officer may, pursuant to section 80 of the Act, approve the transition plan referenced in subsection 11(1), subject to any terms the Chief Executive Officer considers appropriate if the Chief Executive Officer considers that approval of the transition plan is in the best interests of the members of the credit union and that the credit union will meet the requirements to maintain the minimum Tier 1 capital ratio, the minimum capital conservation buffer ratio and the minimum total supervisory capital ratio within a reasonable time.

## **12. Leverage Ratio**

- 12(1) Leverage ratio means the capital measure expressed as a percentage of the exposure measure.
- 12(2) Capital measure means, at a specific point in time, the regulatory capital of the credit union.
- 12(3) Exposure measure means the amount calculated using the formula,  $K - L + M$ .
- 12(4) In subsection 12(3), “K” means the total assets of the credit union as they would appear in the financial statements of the credit union, if the financial statements were prepared as of the date of the calculation.
- 12(5) In subsection 12(3), “L” means the sum of the amounts calculated pursuant to subsection 4(4) as they would appear in the financial statements of the credit union, if the financial statements were prepared as of the date of the calculation.
- 12(6) In subsection 12(3), “M” means the sum, as of the date of calculation of the exposure measure, of the face amounts or notional principal amounts of the off-balance sheet exposures of the credit union specified in Table 3 multiplied, for each exposure, by the corresponding conversion factor in column two of Table 3 for that exposure.

### 13. Internal Capital Adequacy Assessment Process

- 13(1) If a credit union has less than \$500 million in assets, and takes appropriate compensating actions and implement controls to allow the credit union to appropriately manage its capital risk, senior management and the board may determine that the credit union is not required to establish an internal capital adequacy assessment process and section 13 does not apply to that credit union.
- 13(2) Subject to subsection 13(1), a credit union must, to comply with section 78 of the Act, establish an internal capital adequacy assessment process.
- 13(3) The internal capital adequacy assessment process of a credit union must include,
- (i) a governance structure;
  - (ii) a capital risk tolerance that is incorporated into the capital policies, business strategies, reporting frameworks, risk management and control functions of the credit union;
  - (iii) a capital management philosophy that contains the capital goals and objectives of the credit union;
  - (iv) a capital policy that describes the credit union's capital management, including capital targets, limits and diversification of funding sources;
  - (v) processes to allow the credit union to periodically measure, manage and monitor the assets of the credit union held for capital purposes and funding requirements;
  - (vi) capital testing metrics, including an analysis of changes to funding requirements under alternative scenarios;
  - (vii) a capital contingency plan to address capital requirements of the credit union in stressed situations;
  - (viii) an assessment of,
    - (a) all risk exposures of a credit union that are not contemplated by this Rule, including market risk exposures, other than interest rate risk, and counterparty credit risk, and
    - (b) the additional capital a credit union determines it should hold to mitigate the additional risks identified in subparagraph 13(3)(viii)(a); and
  - (ix) a stress testing program to manage the credit union's capital risk under normal and stressed conditions that includes
    - (a) a capital risk management framework and controls to identify, measure, manage and monitor a credit union's capital risk exposures under normal conditions;
    - (b) a structurally sound funding plan; and
    - (c) reasonable stress testing scenarios that
      - (i) stress the credit union's capital levels and capital risk tolerance, and
      - (ii) ensure that the credit union's capital sources and contingency funding plans continue to be adequate in highly unlikely but plausible scenarios.

#### **14. Failure to Comply with Capital Requirements**

- 14(1) If a credit union does not meet the requirements for adequate capital under section 77 of the Act and this Rule the credit union must,
- (i) not, until the credit union meets the requirements for adequate capital,
    - (a) change the terms and conditions of or refinance any loan made by the credit union if this would have an adverse impact on any of the credit union's compliance with section 3; or
    - (b) directly or indirectly make any loan or investment; and
  - (ii) immediately submit to the Chief Executive Officer a report addressing the following matters,
    - (a) the circumstances that caused the credit union to not meet the requirements for adequate capital;
    - (b) the actions the credit union has taken to meet the requirements for adequate capital; and
    - (c) the date on which the credit union expects to comply with the requirements for adequate capital.

#### **15. Coming into force**

- 15(1) This Rule will come into force on the later of the date that clauses 10 and 11 of subsection 285(1) of the Act come into force and 15 days after the Rule is approved by the Minister.