Capital Adequacy Requirements for Credit Unions and Caisses Populaires – FSRA Rule 2021 – 002

FSRA
Financial Services Regulatory Authority of Ontario

Technical Briefing
Date: Monday, February 28th, 2022

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Introduction

i. Section 78 (1) of the CUCPA 2020 states that a credit union shall establish **capital** and liquidity policies for the credit union consistent with the **Authority rules governing adequate capital** and liquidity and the credit union shall adhere to those policies

ii. Presently, under CUCPA, 1994, section 15 to 20 of the O. Reg. 237/09 , specifies minimum capital ratio limits and components of capital

iii. Under CUCPA 2020, **Capital Adequacy Requirements for Credit Unions and Caisses Populaires Rule** ("Capital Rule") defines minimum capital ratio limits (risk weighted and leverage) and components of capital like Tier 1 capital, Tier 2 capital , risk weighted assets (RWA) and net assets

Overview of Capital Rule

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Section 1 – Interpretation

Section 2 – Scope

Section 3 – Minimum Capital Ratios, Capital Conservation Buffer Ratio and Leverage Ratio

Section 4 – Regulatory Adjustments to Capital

Section 5 – Tier 1 Capital

Section 6 – Tier 2 Capital

Section 7 – Investments in the Capital Instruments and other TLAC Instruments of Financial Institutions and Foreign Institutions (New)

Section 8 – Equity Investments in Funds (New section)

Section 9 – Total Assets

Section 10 – Risk Weighted Assets

Section 11 – Credit Risk – Standardized Approach (Expanded the "Tables" to include additional asset categories)

Section 12 – Operational Risk – Basic Indicator Approach

Section 13 – General Market – Interest Rate Risk

Section 14 – Capital Conservation Buffer

Section 15 – Transition Rule for Minimum Capital Ratios and Capital Conservation Buffer

Section 16 – Leverage Ratio

Section 17 – Internal Capital Adequacy Assessment Process

Section 18 – Failure to Comply with Capital Requirements

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Scope of Rule 2021-002

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For CUs with subsidiaries, capital ratios are to be calculated based on the consolidated financial statements of a credit union, except for any subsidiary that is :

i. an insurer ; or

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

For an exclusion from consolidated capital reporting under ii) above, the credit union must request explicit approval from FSRA.

Main Differences between Current Regulations vs new Capital Rule

	O. Reg. 237/09	Capital Rule
1.	Capital ratios are calculated on an **unconsolidated basis** and investment in subsidiary is calculated using equity method (section 16(2) of O.Reg 237/09)	Capital ratios are calculated on a **consolidated basis** (Section 2 of Capital Rule)
2.	Mainly focuses on the adequacy of capital ratios	Focuses on composition and adequacy of CU's capital, including requirement of capital buffer
3.	CU's capital/Pillar I risks monitored via **two ratios** mainly: BIS ratio and Leverage ratio	CU's capital/Pillar I risks monitored via **five ratios** : Tier 1 capital ratio, Capital conservation buffer (CCB) ratio, Risk Weighted Capital ratio, Supervisory capital ratio, and Leverage ratio
4.	Assets of a credit union are mainly classified into **five** categories of risk weights (0%, 20%, 35%, 75%, 100%)	Assets of a credit union are mainly classified into **nine** categories of risk weights (0%, 20%, 35%, 50%, 75%, 100%,150%, 250% and 1250%)
5.	Investments are risk weighted based on the issuer and the type of investments	New methodologies included to risk weight various types of investments

Key Capital Ratios (Section 3(13), Table 1)

	Ratios	Minimum	Formula
1.	Tier 1 capital ratio	6.5%	Tier 1 capital ÷ RWA
2.	Retained Earnings ratio	3.0%	Retained Earnings ÷ RWA
3.	Total capital ratio	8.0%	(Tier 1 capital + Tier 2 capital)÷ RWA
4.	Capital conservation buffer ratio	2.5%	Excess of tier 1 capital over minimum required to meet the “Tier 1 capital ratio” and the “Total capital ratio”
5.	Total supervisory capital ratio	10.5%	(Tier 1 capital + Tier 2 capital)÷ RWA
6.	Leverage ratio	3.0%	(Tier 1 capital + Tier 2 capital)÷ Net assets

Failure to meet minimum Capital Conservation Buffer (CCB)

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- As outlined in section 14, if a credit union's CCB ratio is below the minimum amount of 2.5% of RWA, the credit union
  - must immediately develop a plan to meet or exceed the minimum level where the plan includes: (a) the strategy the credit union will use to complete the plan; (b) the timeframe for the plan; and (c) if the credit union expects to complete the plan promptly, assurances that the CCB recovery is not temporary
  - must promptly provide the plan to its Board and FSRA
- When a credit union's CCB is below the minimum, it must limit distributions as outlined in Table 5 of the Capital Rule:

CU's actual capital conservation buffer as a percentage of the minimum capital conservation buffer required for a credit union	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%

Failure to Meet Capital Requirements in the Capital Rule At the Date of Coming into Force

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- As outlined in section 15, if, on the date 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.
- The application must be in a form approved by the FSRA CEO and describe how an when the credit union will meet the minimum capital requirements
- The CEO may approve the transition plan, subject to any terms outlined by the CEO, if the plan is in the best interests of the members of the credit union and the credit union will meet the requirements to maintain minimum capital levels within a reasonable time

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Failure to Meet Capital Requirements in the Capital Rule After the Date of Coming into Force

- As outlined in section 18, if a credit union does not meet the requirements for adequate capital under section 77 of the CUCPA, 2020, the Capital Rule states that the credit union must:

- (1) Not 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 the capital ratios, or directly or indirectly make any loan; and

- (2) Immediately submit to the Chief Executive Officer (FSRA) a report addressing (1) the circumstances that caused the credit union to not meet the requirements for adequate capital, (2) the actions the credit union has taken to meet the requirements for adequate capital, and (3) the date on which the credit union expects to comply with the requirements for adequate capital

- Section 18 above is **not applicable** to CUs that have:

i. Not met minimum CCB ratio

ii. Not met minimum supervisory capital ratio because of not meeting the CCB ratio

iii. Applied for transition period pursuant to section 15

Reporting Requirements

- MiR Reporting requirements are driven by the Rule, template reflects requirements
- MiR update is in progress
- Updated MiR will consist of two reporting sets:
  - Full-scale schedule for all credit unions
  - Consolidated schedule required for the calculation of consolidated capital adequacy, applicable to credit unions with consolidating subsidiaries or affiliates
- FSRA provided a template as a tool to
  - help calculate the capital ratios
  - help prepare for changes to reporting systems
- The template should be used to calculate and report the Key Capital metrics
  - Monthly, for all credit unions regardless of consolidating subsidiaries
  - At fiscal quarter ends, for credit unions with consolidating subsidiaries or affiliates
- The template can be used for the calculation of both consolidated or unconsolidated capital metrics
- It is not required to file the template, only the Key Capital metrics

Capital Reporting Implementation Plan

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- MARCH: New Act and Capital Rule Comes Into Force
- APRIL
- MAY: 6 Key Capital Metrics available in MiR for manual input
- JUNE: First MiR Update Ready
- JULY
- AUG
- SEPT: Second MiR Update Ready

	MARCH	APRIL	MAY	JUNE – AUG	SEPT
No consolidating subsidiaries	No changes in reporting	No changes in reporting	Monthly MiR + 6 Key Capital Metrics manual input **USE TEMPLATE**	Monthly MiR (updated to new capital metrics) automated Capital Metrics calculation **AUTOMATED**	Fully Updated MiR **AUTOMATED FOR CONSOLIDATED AND UNCONSOLIDATED REPORTING**
Consolidating subsidiaries			Monthly MiR	Monthly MiR (unconsolidated) + 6 Consolidated Key Capital Metrics at fiscal quarter end, manual input **AUTOMATED** **USE TEMPLATE**	

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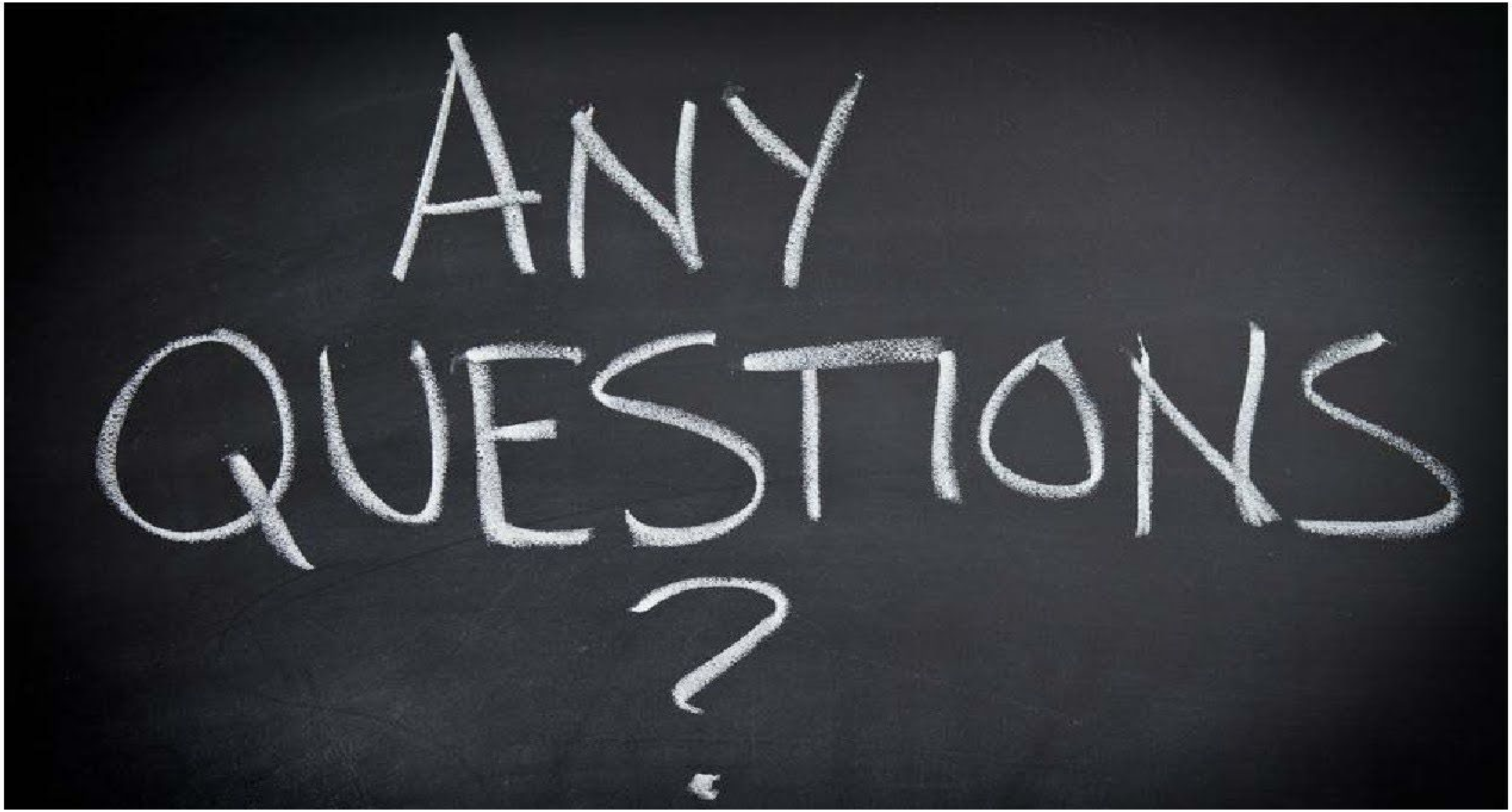
Walkthrough of the Excel Template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QUESTIONS
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