FSRA
Financial Services Regulatory Authority of Ontario

Interpretation

Effective Date: May 7, 2020
Identifier: No. CU0062INT

Credit Unions and Caisses Populaires – Capital Treatment of Loans under the Federal Government Business Credit Availability Program

Purpose and Scope

The purpose of this Guidance[1] is to provide FSRA's Interpretation with respect to the capital treatment for loans provided by Ontario credit unions and caisses populaires (collectively "Credit Unions") under the federal government's Business Credit Availability Program (BCAP), in order to facilitate participation in the Programs for the benefit of their SME members. This Interpretation Guidance interprets the application of the capital adequacy requirements for Credit Unions set out in Sections 15 to 18 of Ontario Regulation 237/09 (the "Regulation") under the *Credit Unions and Caisses Populaires Act, 1994* (the "CUCPA") and the *Capital Adequacy Guideline for Ontario's Credit Unions and Caisses Populaires*

[1] The guidance is being published as an Interpretation under FSRA's Guidance Framework.

(the “CAG”) to loans provided by Credit Unions under the BCAP.

This Interpretation Guidance applies to all Credit Unions incorporated under the CUCPA.

Rationale and Context

On March 27, 2020, the Government of Canada announced the BCAP to support access to financing for Canadian small and medium size enterprises (collectively “SMEs”) in light of the uncertainty resulting from the COVID-19 pandemic. The BCAP includes the following three (3) programs (collectively “the Programs”):

- Canada Emergency Business Account (“CEBA”);
- Export Development Canada (“EDC”) Loan Guarantee (the “Loan Guarantee”) for SMEs; and
- Business Development Bank of Canada (“BDC”) Co-Lending Program (the “Co-Lending Program”) for SMEs.

The Government of Canada has directed SMEs to their primary financial institution to apply to participate in the Programs. A number of Ontario credit unions have already begun to provide loans to their SME members under the Programs. Details of the Programs can be found in Canada's COVID-19 Economic Response Plan: Support for Businesses.

FSRA takes a principles-based and outcomes-focused approach to regulation. FSRA Guidance aims to ensure that Credit Unions will be appropriately capitalized for the risks they take and act prudently to identify and manage risks, and sources and uses of capital and liquidity, so that they will be profitable and competitive businesses, serving their member needs. In supervising and regulating Credit Unions, FSRA is required to administer the CUCPA in a manner that will fulfill FSRA’s mandate[2], which includes:

- providing insurance against the loss of part or all of deposits with credit unions;
- promoting and otherwise contributing 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; and

[2] See Section 3(4) of the *Financial Services Regulatory Authority of Ontario Act*, 2016, S.O. 2016, c. 37.

- pursuing the above objects 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

This Interpretation Guidance supports the achievement of FSRA's mandate as outlined above.

Interpretation - Capital Treatment of Loans under the BCAP Pursuant to Sections 15 to 18 of Ontario Regulation 237/09

i. Canada Emergency Business Account

Under the CEBA, EDC provides interest-free loans to SMEs, to help cover their immediate operating costs where revenues have been adversely impacted by the COVID-19 pandemic.

These loans are fully funded by the Government of Canada through funds available in the CEBA. Credit Unions providing loans funded through the CEBA can exclude them from their calculations of regulatory capital as both a percentage of risk-weighted assets (the "risk-weighted capital ratio") and as a percentage of total assets (the "leverage ratio"), calculated in accordance with the Regulation.

If these loans are to be included as assets in the financial statements of a Credit Union as a result of following Generally Accepted Accounting Principles ("GAAP"), then FSRA's interpretation is that the following capital treatment under the Regulation is to be applied:

- For purposes of the calculation of the risk-weighted capital ratio, Credit Unions providing loans under the CEBA may apply a zero per cent (0%) risk weighting to the loan in accordance with section 18(2) of the Regulation.[3]
- For purposes of the calculation of the leverage ratio, FSRA hereby amends its CAG so that the exposure would be deducted from the Credit Union's assets when calculating its total assets of the credit union in accordance with section 16(1) of the Regulation.

[3] For the purposes of calculating a credit union's risk weighted assets, Section 18(2) 2. provides that percentage is zero percent (0%) for claims against, or guaranteed by, the Government of Canada or an agency of the Government.

ii. Export Development Canada Loan Guarantee for SMEs

The Loan Guarantee provides credit and cash flow term loans to SMEs that were otherwise financially viable and revenue generating prior to the COVID-19 outbreak. EDC guarantees eighty per cent (80%) of any loans provided by financial institutions under this Program.

When calculating the risk-weighted capital ratio in accordance with the Regulation, Credit Unions providing these loans may apply a zero per cent (0%) risk weighting to the portion of the loan that is guaranteed by EDC, in accordance with section 18(2) of the Regulation.[4] The remaining portion of the loan is to be treated as a regular commercial loan and risk-weighted in accordance with the CAG based on the external credit rating of the borrower. If the borrower does not have an external credit rating, then the remaining portion of the loan is to be risk-weighted at either seventy five per cent (75%) or one hundred per cent (100%), depending on the relative size of the loan, in accordance with section 18(5) or 18(6), respectively, of the Regulation.

When calculating the leverage ratio in accordance with the Regulation, the entire amount of the loan is to be included in the calculation of total assets of the Credit Union in accordance with section 16 of the Regulation.

iii. Business Development Bank of Canada (BDC) Co-lending Program for SMEs

The Co-lending Program provides term loans for operational and liquidity needs of SMEs that were financially viable and revenue-generating prior to the COVID-19 outbreak. Under this program, BDC would hold an eighty per cent (80%) portion of the loan and the participating financial institution would hold a twenty per cent (20%) portion of the loan that is made to the borrower.

The eighty per cent (80%) portion of the loan held by BDC is an asset of BDC and does not represent an asset of the Credit Union. Therefore, the portion of the loan held by BDC would not be included in the risk-weighted capital and leverage ratio calculations. Credit Unions participating in these loans would need to account for the twenty per cent (20%) portion of the

[4] Since EDC, which is a crown corporation and an agency of the Government, guarantees eighty percent (80%) of the loan, for the purposes of calculating a credit union’s risk weighted assets, that portion of the loan will be afforded a zero percent (0%) in accordance with Section 18(2) 2.of the Regulation.

loan that they hold when calculating both their risk-weighted capital and leverage ratios in accordance with the Regulation. In calculating the risk-weighted capital ratio, the portion of the loan that is provided and held by the Credit Union is to be treated as a regular commercial loan and risk-weighted in accordance with the CAG based on the external credit rating of the borrower. If the borrower does not have an external credit rating, then the portion of the loan that is provided and held by the Credit Union is to be risk-weighted at either seventy five per cent (75%) or one hundred per cent (100%), depending on the relative size of the loan, in accordance with section 18(5) or 18(6), respectively, of the Regulation.

Liquidity Treatment

Where the Credit Union has provided a loan through any of the BCAP programs, the inflows and outflows of those loans, and any funding which will be received on account of those loans, should be properly taken into account by the Credit Union in its liquidity management and reporting (i.e. its Liquidity Coverage Ratio). With respect to the BDC Co-lending Program, since the Credit Union is only obligated to fund the portion of the loan provided by the Credit Union, it would only need to consider the cash flow payments relating to that portion of the loan in its cash flow analysis.

Credit unions should refer to FSRA's liquidity guidance provided on FSRA's web site.

Contact

FSRA's Relationship Managers are in active contact with Credit Unions and are responding to their inquiries. We will continue to remain in close contact and be responsive to any questions you may have, as well as share any additional information. Credit unions should reach out to their FSRA Relationship Managers with any questions on the application of existing capital adequacy requirements.

Supervision and Credit Union Obligations

Credit Unions are required to comply with the CUCPA, the Regulation and the CAG, as interpreted by this Interpretation Guidance. Credit Unions have responsibility for their underwriting practices. Credit Unions should ensure that their participation in the BCAP is prudent and that their business is carried on primarily for the benefit of their members. The failure of a Credit Union to comply may result in supervisory action by FSRA.

Effective Date and Future Review

This Interpretation Guidance becomes effective on May 7, 2020.

The latest possible date for FSRA to initiate a review of this Interpretation Guidance will be May 6, 2025.