FSRA
Financial Services Regulatory Authority of Ontario

ARSF
Autorité ontarienne de réglementation des services financiers

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Sector Outlook Report 1Q-2020

Ontario Credit Unions and Caisses Populaires

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Notes

The Sector Outlook is published on a quarterly basis and provides analysis and commentary about the economy and most recent financial results reported by credit unions and caisses populaires in the Ontario sector.

Throughout this document, unless specifically indicated otherwise, references to credit unions means both credit unions and caisses populaires.

Disclaimer

The information presented in this report has been prepared using unaudited financial filings submitted by credit unions to FSRA as of April 28, 2020 and as such accuracy and completeness cannot be guaranteed. Income Statement results are based on aggregate year-to-date annualized information for each credit union.

Electronic Publication

The Sector Outlook is available in PDF format (readable using Adobe Acrobat Reader) and can be downloaded from the Publications section on the Credit Unions and Caisses Populaires page on FSRA's website at www.fsrao.ca.

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Ce document est également disponible en français.

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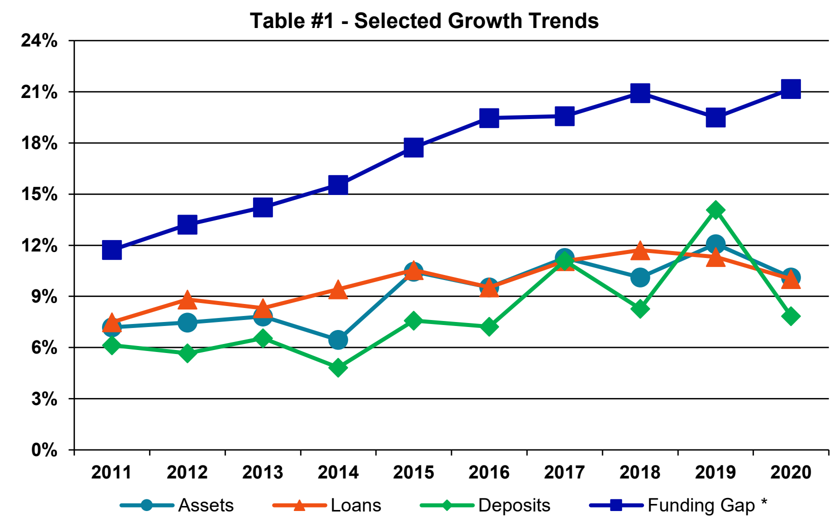
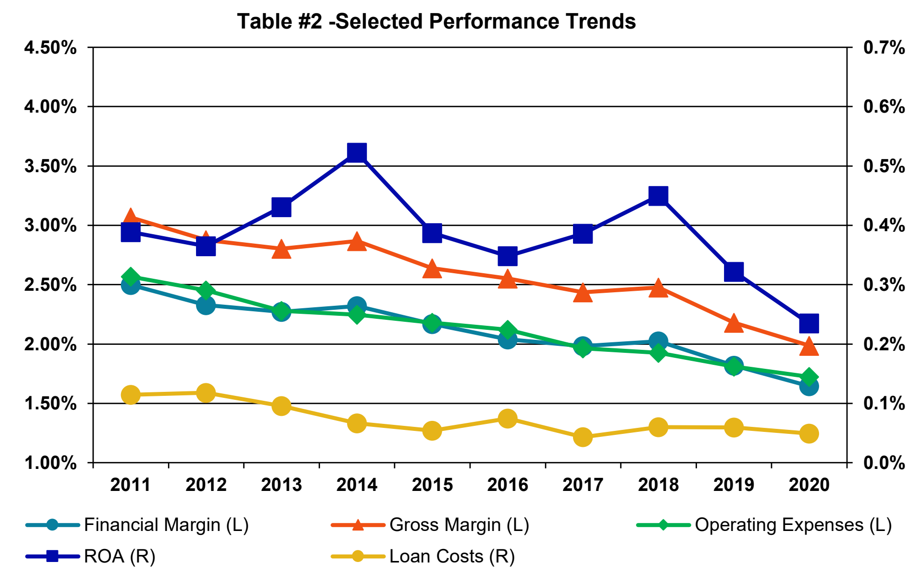
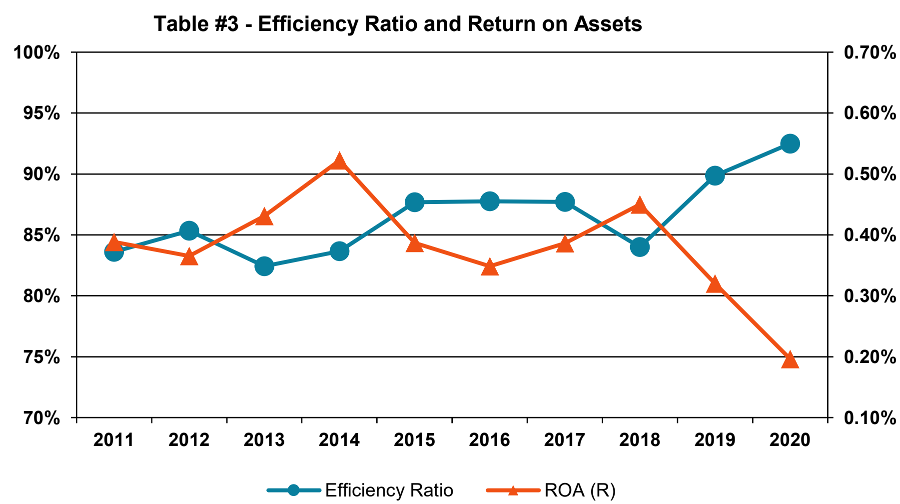
Financial Highlights

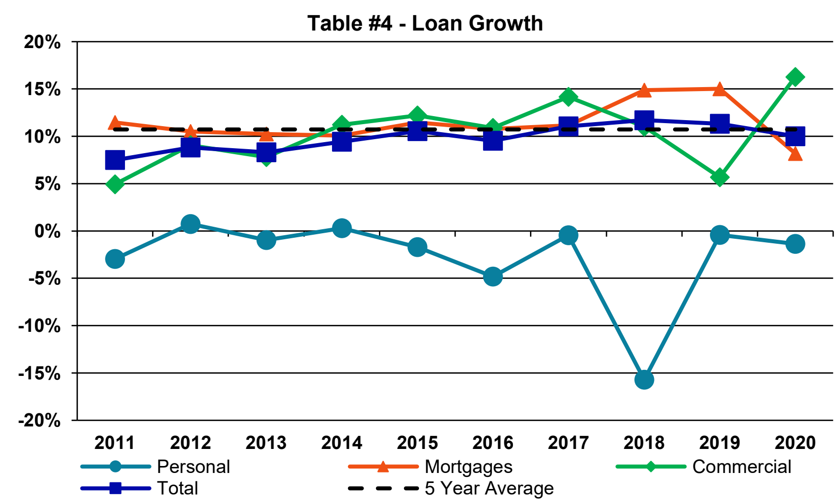
	Ontario Sector		
	1Q-2020*	4Q-2019	1Q-2019
Income Statement (% average assets)			
Net Interest Income	1.61[3]	1.80	1.77
Loan Costs	0.10[3]	0.05	0.06
Other Income	0.44[3]	0.46	0.42
Non-Interest Expense	1.72[1]	1.80	1.81
Taxes	0.03[1]	0.08	0.05
Net Income	0.20[3]	0.34	0.27
Balance Sheet ($ billions; as at quarter end)			
Assets	72.0[1]	70.4	65.4
Loans	62.3[1]	61.1	56.7
Deposits	56.8[1]	55.6	52.6
Members' Equity & Capital	5.0[1]	4.85	4.42
Capital Ratios (%)			
Leverage	6.88[1]	6.82	6.71
Risk Weighted	13.52[1]	13.39	13.17
Key Measures and Ratios (% except as noted)			
Return on Regulatory Capital	2.89[3]	5.06	4.03
Liquidity Ratio	10.8[1]	10.7	11.0
Efficiency Ratio (before dividends/rebates)	85.9[3]	78.4	82.2
Efficiency Ratio	88.5[3]	81.5	84.9
Mortgage Loan Delinquency>30 days	0.44[3]	0.41	0.43
Commercial Loan Delinquency>30 days	1.29[3]	1.16	0.96
Total Loan Delinquency>30 days	0.75[3]	0.67	0.62
Total Loan Delinquency>90 days	0.38[3]	0.29	0.31
Asset Growth (from last quarter)	2.28[3]	3.04	3.24
Loan Growth (from last quarter)	2.06[3]	3.68	1.55
Deposit Growth (from last quarter)	1.99[1]	1.17	3.33
Credit Unions (number)	66[3]	77	78
Membership (thousands)	1,731[1]	1,700	1,686
Average Assets ($ millions, per credit union)	1,091[1]	914	838
* Trends are current quarter to last quarter	Better	Neutral	Worse

Sector Key Financial Trends









Sector Key Financial Trends (Continued)

Table #5 - Loan Delinquencies - Greater than 30 days

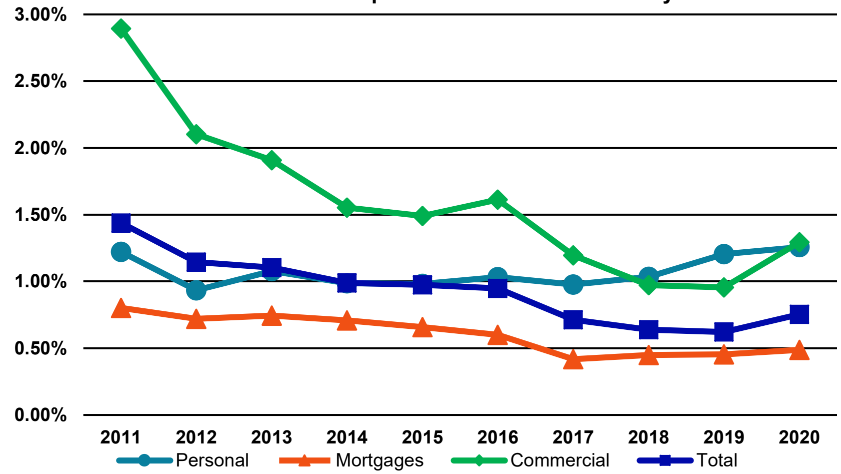


Table #6 - Loan Yields

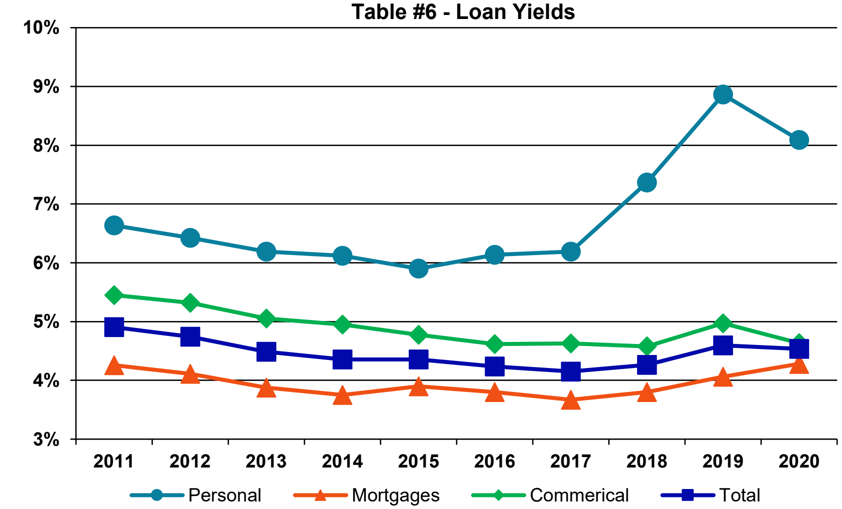


Table #7 - Deposit Growth

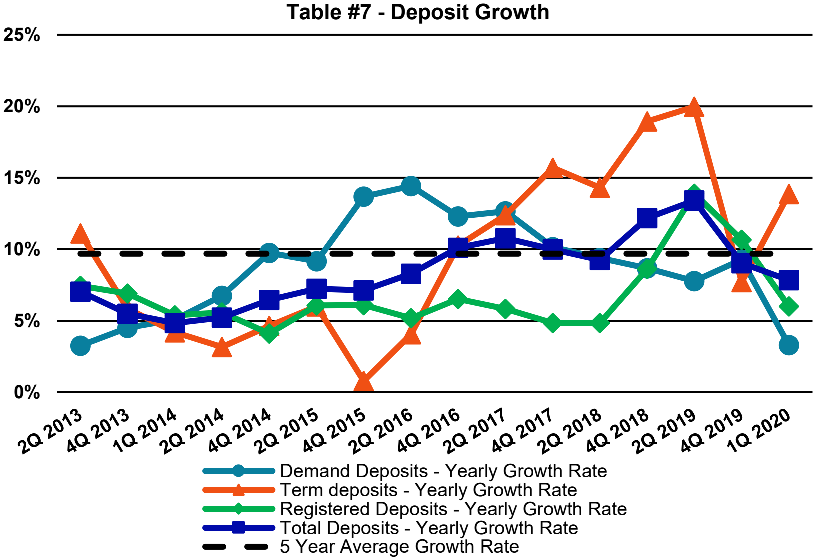
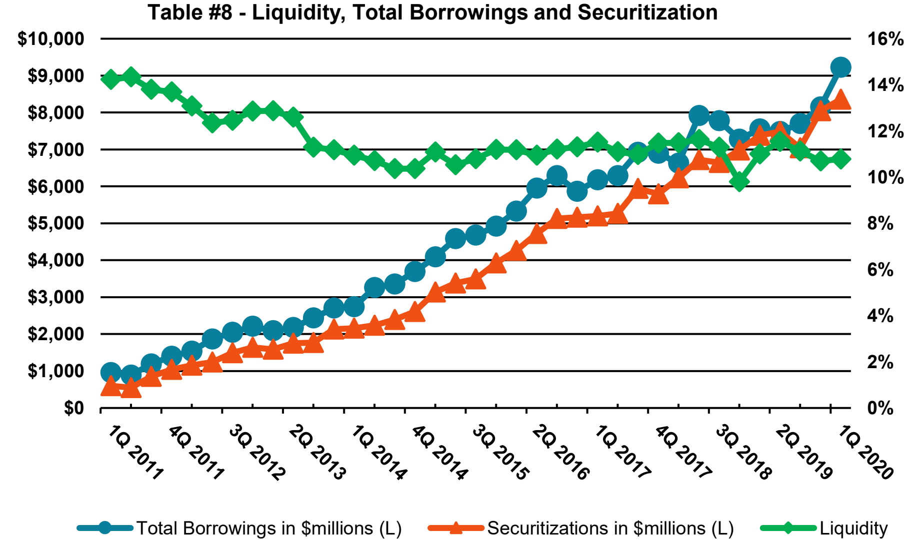


Table #8 - Liquidity, Total Borrowings and Securitization



FSRA Observations 1Q-2020

- Profitability this quarter at 20 bps is down by 7 bps year over year (from 27 bps) and 14 bps quarter over quarter (from 34 bps); the effects of derivatives revalued in March 2020 as markets reacted to the effects of COVID-19 and higher loan costs more than offset improving non-interest expenses.
- Over 30 day delinquency on residential mortgages (which represent 54% of sector assets) was 44 bps, an increase of 1 bp year over year and 3 bps from last quarter. Increases are likely to continue due to the effects of COVID-19 coupled with high household debt levels.
- Total loan delinquency over 30 days at 75 bps deteriorated by 13 bps year over year (from 62 bps) and 8 bps quarter over quarter (from 67 bps) mainly reflecting the impact of commercial loan performance of 129 bps (worse by 33 bps year over year and 13 bps quarter over quarter).
- Asset growth of $6.6 billion (10.1% year over year) was almost equally split between growth in residential mortgage loans of $2.9 billion (up 8.2%) and commercial loans of $2.6 billion (up 16.3%).
- Year over year loan growth at 10.0% outpaced deposit growth at 7.8% leading to increased reliance on bank borrowings (up 58.2%) and securitization activities (up 19.3%) as sources of funding; growth rates this quarter were similar as loans and deposits grew 2.1% and 2.0% respectively.
- Liquidity decreased 20 bps year over year to 10.8% as growth in deposits, borrowings and securitization transactions exceeded growth in liquid assets.
- Year over year growth in retained earnings (10.3%) kept pace with growth in assets (10.1%), however capital and capital ratios remain under pressure. To maintain minimum capital requirements and provide for future growth, credit unions have an increasing dependency on the issuance of investment shares ($308 million, up 18.1% year over year) which remain a significant portion of capital composition (40.4% in 1Q-2020 versus 38.6% in 1Q-2019).

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Economic Overview

The Bank of Canada (the "Bank") met June 3rd, 2020 and held the overnight rate at 0.25%, unchanged since March 27th, 2020. There were three rate decreases in March totalling 1.50% as the severity of the COVID-19 pandemic became known.

In its release, the Bank said "Incoming data confirm the severe impact of the COVID-19 pandemic on the global economy. This impact appears to have peaked, although uncertainty about how the recovery will unfold remains high. Massive policy responses in advanced economies have helped to replace lost income and cushion the effect of economic shutdowns. Financial conditions have improved, and commodity prices have risen in recent weeks after falling sharply earlier this year. Because different countries' containment measures will be lifted at different times, the global recovery likely will be protracted and uneven."

In Canada, the pandemic has led to historic losses in output and jobs. Still, the Canadian economy appears to have avoided the most severe scenario presented in the Bank's April *Monetary Policy Report* (MPR). The level of real GDP in the first quarter was 2.1 percent, lower than in the fourth quarter of 2019. This GDP reading is in the middle of the Bank's April monitoring range and reflects the combined impact of falling oil prices and widespread shutdowns. The level of real GDP in the second quarter will likely show a further decline of 10 to 20 percent, as continued shutdowns and sharply lower investment in the energy sector take a further toll on output. Decisive and targeted fiscal actions, combined with lower interest rates, are buffering the impact of the shutdown on disposable income and helping to lay the foundation for economic recovery. While the outlook for the second half of 2020 and beyond remains heavily clouded, the Bank expects the economy to resume growth in the third quarter. CPI inflation has decreased to near zero, as anticipated in the April MPR, mainly due to lower prices for gasoline. The Bank expects temporary factors to keep CPI inflation below the target band in the near term. The Bank's core measures of inflation have drifted down, although by much less than the CPI, and are now between 1.6 and 2 percent.

The Bank's programs to improve market function are having their intended effect. After significant strains in March, short-term funding conditions have improved. Therefore, the Bank is reducing the frequency of its term repo operations to once per week, and its program to purchase bankers' acceptances to bi-weekly operations. The Bank stands ready to adjust these programs if market conditions warrant. Meanwhile, its other programs to purchase federal, provincial, and corporate debt are continuing at their present frequency and scope.

As market function improves and containment restrictions ease, the Bank's focus will shift to supporting the resumption of growth in output and employment. The Bank maintains its commitment to continue large-scale asset purchases until the economic recovery is well underway. Any further policy actions would be calibrated to provide the necessary degree of monetary policy accommodation required to achieve the inflation target.

According to data released March 13th, 2020 by Statistics Canada, household debt to disposable income was almost unchanged at 176.3 percent in the quarter ended December 31, 2019 compared to a revised 176.6 percent in the previous quarter.

Housing Markets

In a May 27th, 2020 release Canada Mortgage and Housing Corporation said it believes the housing market will see declines in 2020 and should start to improve this time next year. It also said housing starts, sales and prices are likely to remain below their pre-COVID-19 levels into 2022.

The Toronto Real Estate Board reported that in May 2020, compared to the year earlier month (a) sales volume in the GTA was 4,606 transactions, down 54% from 9,950; (b) new listings were 9,104, down 53% from 19,394 and (c) average selling price was $864 thousand, up 3% from $838 thousand. The Board noted that the May sales result represented a marked 55% improvement over April 2020 and that with home sales and new listings continuing to trend in unison, market conditions remained balanced. It considers a key factor for the housing market recovery will be a broader reopening of the economy, which will result in improving employment and a resurgence in consumer confidence.

Credit Union Sector Consolidation

Effective January 1, 2020, two credit unions amalgamated (resulting in 64) and 11 caisses populaires amalgamated (resulting in 2) reducing the number of institutions from 77 to 66. Such consolidations should result in larger, more stable entities capable of achieving economies of scale.

Profitability

1Q-2020 vs 1Q-2019

As shown in Tables 2 and 3, return on average assets for the sector decreased sharply to 20 bps (down 7 bps from 27 bps) from the same quarter a year earlier due to lower investment income (down 6 bps to 9 bps as derivative contracts were marked to market in March 2020), lower loan interest (down 7 bps to 3.29%) and higher loan costs (up 4 bps to 10 bps) that more than offset improved non-interest expenses (down 9 bps to 1.72%).

Out of 66 credit unions, nine had negative returns on assets. FSRA closely monitors those that are unprofitable, identifies core challenges and works with the credit unions to develop strategies to restore profitability.

4Q 2019 Ontario Sector vs Canadian Sector*

***Most recent report by Canadian Credit Union Association; including Ontario sector**

Ontario sector profitability of 34 bps was 4 bps below that of the Canadian sector of 38 bps.

Capital

1Q-2020 vs 1Q-2019

Sector capital increased to $5.0 billion (up $560 million or 12.7%) from the year earlier quarter comprised of:

- Retained earnings of $2.9 billion (up $273 million or 10.3%);
- Investment and patronage shares of $2.0 billion (up $305 million or 18.1%); and
- Membership shares of $64 million (down $1 million or 2.1%)

As a percent of risk weighted assets, sector capital was 13.52%, up 35 bps from the year earlier quarter, as growth in capital outpaced growth in risk weighted assets. Leverage was 6.88%, up 17 bps from the year earlier quarter.

1Q-2020 vs 4Q-2019

Sector capital increased by $127 million (2.6% from $4.9 billion) from last quarter from issuances of investment shares of $89 million (4.6% from $1.9 billion) and increases in retained earnings of $54 million (1.9% from $2.9 billion); membership shares increased by $1 million (1.7% from $63 million).

Sector capital as a percent of risk weighted assets increased 13 bps (from 13.39%) in the previous quarter. Leverage increased 6 bps (from 6.82%).

Liquidity (including Securitization)

1Q-2020 vs 1Q-2019

As shown in Tables 7 and 8, sector deposits increased by $4.1 billion (up 7.8% to $56.8 billion), securitizations increased by $1.4 billion (up 19.3% to $8.4 billion) and borrowings increased by $319 million (58.2% to $867 million), a net increase of $5.8 billion (up 9.6% to $66.0 billion) from the year earlier. However, liquid assets increased $483 million (up 7.3% to $7.1 billion) resulting in a decrease in liquidity to 10.8% (down 20 bps from 11.0% in 1Q-2019).

In 1Q-2020, there were 23 institutions (21 credit unions and 2 caisse populaires) with combined total assets of $63.0 billion (89% of sector assets) participating in securitization programs.

1Q-2020 vs 4Q-2019

Sector deposits increased by $1.1 billion (up 2.0% from $55.6 billion), securitizations increased by $313 million (up 3.9% from $8.0 billion) and borrowings increased by $24 million (up 2.8% from $843 million), a net increase of $1.5 billion (up 2.2% from $64.5 billion) from last quarter. However, liquid assets increased by $205 million (up 3.0% from $6.9 billion) resulting in an increase of 10 bps in liquidity (from 10.7%).

Efficiency Ratio (before dividends/interest rebates)

1Q-2020 vs 1Q-2019

As shown in Table 3, sector efficiency ratio deteriorated to 85.9% (up 370 bps from 82.2%) from the year earlier quarter.

1Q-2020 vs 4Q-2019

Compared to last quarter, sector efficiency deteriorated by 750 bps (from 78.4%).

4Q-2019 Ontario Sector vs. Canadian Sector

Although non-interest expense as a percent of average assets for the Ontario sector (1.80%) was 9 bps better than the Canadian sector (1.89%), the efficiency ratio (78.4%) was 340 bps worse than the Canadian sector (75.0%). This gap is an improvement from 4Q-2018 when the spread was 430 bps with Ontario at 77.7% and the Canadian Sector at 73.4%.

Credit Quality (delinquency greater than 30 days)

1Q-2020 vs 1Q-2019

As shown in Table 5, total loan delinquency increased to 75 bps (up 13 bps from 62 bps) compared to the year earlier quarter. Residential mortgage loan delinquency increased to 44 bps (up 1 bp from 43 bps) and commercial loan delinquency increased to 129 bps (up 33 bps from 96 bps).

1Q-2020 vs 4Q-2019

Compared to last quarter, total loan delinquency increased by 8 bp (from 67 bps) reflecting increases in residential mortgage loan delinquency of 3 bps (from 41 bps) and commercial loan delinquency of 13 bps (from 116 bps).

Growth

1Q-2020 vs 1Q-2019

Compared to the previous year, total sector assets increased to $72.0 billion (up $6.6 billion or 10.1%). This was largely due to growth in residential mortgage loans to $38.9 billion (up $2.9 billion or 8.2%), growth in commercial loans to $18.8 billion (up $2.6 billion or 16.3%) and increased cash/investments of $8.5 billion (up $814 million or 10.6%).

1Q-2020 vs 4Q-2019

Total assets for the sector increased by $1.6 billion (2.3% from $70.4 billion) from last quarter reflecting growth of $794 million (2.1% from $38.1 billion) in residential mortgage loans, increases in commercial loans of $446 million (2.4% from $18.3 billion) and increased cash/equivalent balances of $354 million (4.3% from $8.1 billion).

4Q-2019 Ontario Sector vs. Canadian Sector

Ontario sector total assets growth rate of 10.9% was greater than the Canadian sector's (6.0%) reflecting growth in residential mortgages loans of 11.2% (vs 4.8%), commercial loans of 7.0% (vs 6.8%) and agricultural loans of 7.8% (vs 5.8%).

Sector Income Statements

% of Average Assets (except as noted)	Ontario Sector			Canadian Sector[1]
	1Q-2020	4Q-2019	1Q-2019	4Q-2019
Interest and Investment Income				
Loan Interest	3.29%	3.38%	3.36%	3.29%
Investment Income	0.09%	0.26%	0.15%	0.31%
Total Interest and Investment Income	3.38%	3.64%	3.52%	3.60%
Interest and Dividend Expense				
Interest Expense on Deposits	1.40%	1.45%	1.40%	1.45%
Rebates/Dividends on Share Capital	0.04%	0.07%	0.05%	-
Dividends on Investment/Other Capital	0.01%	0.02%	0.01%	0.09%
Other Interest Expense	0.30%	0.27%	0.28%	0.15%
Total	0.35%	0.38%	0.35%	0.24%
Total Interest & Dividend Expense	1.77%	1.84%	1.75%	1.69%
Net Interest & Investment Income	1.61%	1.80%	1.77%	1.91%
Loan Costs	0.10%	0.05%	0.06%	0.07%
Net Interest & Investment Income after Loan Costs	1.50%	1.75%	1.71%	1.84%
Other (non-interest) Income	0.44%	0.46%	0.42%	0.52%
Net Interest, Investment & Other Income	1.95%	2.21%	2.13%	2.36%
Non-Interest Expenses				
Salaries & Benefits	0.98%	1.01%	1.03%	
Occupancy	0.16%	0.16%	0.16%	
Computer, Office & Other Equipment	0.18%	0.18%	0.19%	
Advertising & Communications	0.09%	0.10%	0.10%	
Member Security	0.08%	0.08%	0.08%	
Administration	0.15%	0.15%	0.14%	
Other	0.08%	0.11%	0.11%	
Total Non-Interest Expenses	1.72%	1.80%	1.81%	1.89%
Net Income/(Loss) Before Taxes	0.22%	0.41%	0.32%	0.47%
Taxes	0.03%	0.08%	0.05%	0.09%
Net Income/(Loss)	0.20%	0.34%	0.27%	0.38%
Average Assets (Millions)	$71,230	$66,974	$64,237	$239,503

[1]Summary results as reported by Canadian Credit Union Association; includes Ontario Sector

*Totals may not agree due to rounding

Sector Balance Sheets

As at $millions

	Sector		
	1Q-2020	4Q-2019	1Q-2019
Assets			
Cash and Investments	8,493	8,139	7,679
Personal Loans	2,261	2,282	2,293
Residential Mortgage Loans	38,852	38,058	35,913
Commercial Loans	18,751	18,305	16,126
Institutional Loans	109	122	99
Unincorporated Association Loans	97	97	104
Agricultural Loans	2,275	2,222	2,133
Total Loans	62,345	61,086	56,668
Total Loan Allowances	168	160	152
Capital (Fixed) Assets	708	719	636
Intangible and Other Assets	622	607	552
Total Assets	71,999	70,391	65,384
Liabilities			
Demand Deposits	21,286	21,461	20,608
Term Deposits	22,088	21,220	19,399
Registered Deposits	13,381	12,966	12,624
Other Deposits	0	0	0
Total Deposits	56,755	55,647	52,631
Borrowings	867	843	548
Securitizations	8,360	8,047	7,005
Other Liabilities	1,037	1,000	778
Total Liabilities	67,019	65,538	60,962
Members' Equity & Capital			
Membership Shares	64	63	65
Retained Earnings	2,922	2,868	2,649
Other Tier 1 & 2 Capital	2,013	1,924	1,705
AOCI	(18)	(1)	2
Total Members' Equity & Capital	4,981	4,854	4,421
Total Liabilities, Members' Equity & Capital	71,999	70,391	65,384

* Totals may not agree due to rounding

Sector Balance Sheets

	1Q-2020 $millions	Sector % Increase/(Decrease) from 4Q-2019	Sector % Increase/(Decrease) from 1Q-2019
Assets			
Cash and Investments	8,493	4.3%	10.6%
Personal Loans	2,261	-0.9%	-1.4%
Residential Mortgage Loans	38,852	2.1%	8.2%
Commercial Loans	18,751	2.4%	16.3%
Institutional Loans	109	-11.3%	9.7%
Unincorporated Association Loans	97	-0.2%	-7.3%
Agricultural Loans	2,275	2.4%	6.6%
Total Loans	62,345	2.1%	10.0%
Total Loan Allowances	168	4.8%	10.9%
Capital (Fixed) Assets	708	-1.6%	11.2%
Intangible and Other Assets	622	2.5%	12.8%
Total Assets	71,999	2.3%	10.1%
Liabilities			
Demand Deposits	21,286	-0.8%	3.3%
Term Deposits	22,088	4.1%	13.9%
Registered Deposits	13,381	3.2%	6.0%
Other Deposits	0	0.0%	0.0%
Total Deposits	56,755	2.0%	7.8%
Borrowings	867	2.8%	58.2%
Securitizations	8,360	3.9%	19.3%
Other Liabilities	1,037	3.6%	33.2%
Total Liabilities	67,019	2.3%	9.9%
Members' Equity & Capital			
Membership Shares	64	1.7%	-2.1%
Retained Earnings	2,922	1.9%	10.3%
Other Tier 1 & 2 Capital	2,013	4.6%	18.1%
Accumulated Other Comprehensive Income	(18)	1344.3%	-871.9%
Total Members' Equity & Capital	4,981	2.6%	12.6%
Total Liabilities, Members' Equity & Capital	71,999	2.3%	10.1%

* Totals may not agree due to rounding

Sector Balance Sheets

As a percentage of Total Assets	Sector 1Q-2020	Sector 4Q-2019	Sector 1Q-2019	Canadian Sector[1] 4Q-2019
Assets				
Cash and Investments	11.8%	11.6%	11.7%	14.1%
Personal Loans	3.1%	3.2%	3.5%	4.5%
Residential Mortgage Loans	54.0%	54.1%	54.9%	50.0%
Commercial Loans	26.0%	26.0%	24.7%	24.7%
Institutional Loans	0.2%	0.2%	0.2%	1.1%
Unincorporated Association Loans	0.1%	0.1%	0.2%	0.0%
Agricultural Loans	3.2%	3.2%	3.3%	3.8%
Total Loans	86.6%	86.8%	86.7%	84.1%
Total Loan Allowances	0.2%	0.2%	0.2%	-0.3%
Capital (Fixed) Assets	1.0%	1.0%	1.0%	1.0%
Intangible and Other Assets	0.9%	0.9%	0.8%	1.1%
Total Assets	100.0%	100.0%	100.0%	100.0%
Liabilities				
Demand Deposits	29.6%	30.5%	31.5%	35.9%
Term Deposits	30.7%	30.1%	29.7%	32.2%
Registered Deposits	18.6%	18.4%	19.3%	15.8%
Other Deposits	0.0%	0.0%	0.0%	0.2%
Total Deposits	78.8%	79.1%	80.5%	84.1%
Borrowings	1.2%	1.2%	0.8%	5.9%
Securitizations	11.6%	11.4%	10.7%	0.0%
Other Liabilities	1.4%	1.4%	1.2%	2.9%
Total Liabilities	93.1%	93.1%	93.2%	92.9%
Members' Equity & Capital				
Membership Shares	0.1%	0.1%	0.1%	0.6%
Retained Earnings	4.1%	4.1%	4.1%	5.5%
Other Tier 1 & 2 Capital	2.8%	2.7%	2.6%	1.1%
AOCI	0.0%	0.0%	0.0%	0.0%
Total Members' Equity & Capital	6.9%	6.9%	6.8%	7.2%
Total Liabilities, Members' Equity & Capital	100.0%	100.0%	100.0%	100.0%

[1]As reported by Canadian Credit Union Association; includes Ontario Sector. *Totals may not agree due to rounding