Ontario
Deposit Insurance Corporation of Ontario
Société ontarienne d'assurance-dépôts

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CREDIT UNION SHARES HELD AS SECURITY

A credit union may hold its shares by way of a security interest if the security interest is nominal or immaterial when measured by criteria established by the credit union that have been approved in writing by the Superintendent.

Background

Subsection 61(1) of the *Credit Unions and Caisses Populaires Act, 1994* (the "Act") precludes a credit union from holding its own shares except as permitted under certain circumstances as set out in the Act or prescribed by the regulation. Subsection 61(3) of the Act permits a credit union to hold its shares by way of a security interest if the security interest is nominal or immaterial when measured by criteria established by the credit union *that have been approved in writing by the Superintendent of Financial Services* (the "Superintendent").

Some insured institutions have advanced loans secured by the credit union's shares. This includes loans that were granted for the purpose of investing in membership or investment shares. In many instances the loans for shares received very favourable terms, for example, at no interest and with an extended repayment term. Issuing shares based on a loan granted for such purpose artificially inflates capital and potentially increases the level of risk at a credit union by enabling growth based on that capital. Additionally, since one of the reasons for taking security is to protect the credit union against loan losses, accepting its own shares as security defeats this purpose.

Section 59(1) of the Act prescribes that a credit union may not issue a share, other than patronage shares, until it has received full payment in cash, or with the approval of the Superintendent, in property. Granting loans for the purpose of investing in the credit union's shares does not represent payment in full by way of cash or property. This also poses a conflict of interest as well as potential leveraged investment exposure, particularly if the credit union needs additional capital to meet regulatory standards. The transaction may not be in the member's best interest and, accordingly, is not an appropriate practice.

An exception may be considered where a loan granted for the purchase of shares is fully secured against the member's funds on deposit with the credit union and such cash collateral is segregated or protected so that it cannot be withdrawn by the member or used other than to repay their loan.

DICO's Expectations

Unless specific written approval has been provided by the Superintendent as required under subsection 61(3) of the Act, a credit union that has issued a loan that is secured by its own shares should deduct the amount of the shares held as security minus the balance of the outstanding loan, where it is less than the amount of the shares, when calculating and reporting regulatory capital.

Where this will result in a material change to capital, the credit union should contact their Regional Manager.

In those cases where a credit union fails to make deductions to capital as noted above, DICO will consider appropriate regulatory action.

Legislative Reference

Consideration

59. (1) A credit union shall not issue any share other than a patronage share until the credit union has received full payment for it in cash or, with the approval of the Superintendent, in property.

Holding own shares

61. (1) Except as permitted under this Act or prescribed by regulation, a credit union shall not,

(a) hold shares of the credit union;

(b) permit a subsidiary to hold a greater number of membership shares than the minimum number required for membership in the credit union; or

(c) permit a subsidiary to hold any other shares of the credit union.

Security interest

(3) A credit union may hold its shares by way of a security interest and may permit a subsidiary to do so if the security interest is nominal or immaterial when measured by criteria established by the credit union that have been approved in writing by the Superintendent.