

Consultation Paper
Financial Services Regulatory Authority of Ontario

Updating Ontario's Liquidity Guidance for Credit Unions

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Purpose

The Financial Services Regulatory Authority of Ontario (FSRA) is seeking input from credit union and caisse populaire (CU) stakeholders and the public on proposed amendments to the following existing liquidity guidance documents for Ontario CUs:

- Guidance Note: Liquidity Guidance (2018)
- Guidance Note: Stress Testing – Credit Unions with Assets Greater Than \$500 Million (2017)
- Liquidity Coverage Ratio Completion Guide (2017)
- Net Cumulative Cash Flow Completion Guide (2017)
- Net Stable Funding Ratio Completion Guide (2017)

This consultation paper is organized as follows:

1. The body of the paper provides the rationale for updating the existing liquidity guidance, an overview of the proposed amendments, guiding principles and compliance expectations.
2. Appendix I contains the specific amendments under consideration and explains the rationale for each change.
3. Appendix II to VI provides draft versions of the proposed updated guidance documents, which include the changes outlined in Appendix I.

Request for Feedback

FSRA requests public feedback on the proposed amendments to the liquidity guidance documents described in this consultation paper. Feedback should focus on the proposed amendments and respondents should consider, but are not limited to, answering the following questions:

- Do the proposed amendments support a prudent, risk-based and principles-based approach to managing liquidity for your CU?
- In your opinion, would the proposed amendments improve the safety and protection of CU liquidity, promoting the availability and accessibility of such liquidity to CUs when needed? If not, please describe any additional changes you think should be considered to further promote this objective.

- In your opinion, would the proposed amendments, if adopted, provide an efficient and effective framework for enabling FSRA to monitor CU liquidity? If not, please describe any other changes that you feel would result in a more efficient and effective framework for FSRA to monitor CU liquidity.
- To the extent that the proposed amendments would create additional compliance or reporting obligations, would any barriers exist within your institution to meeting those obligations? Do the proposed amendments result in any unanticipated impacts, positive or negative, to your business?
- Are there any aspects of the proposed amendments to the liquidity guidance documents noted in this paper which are unclear or require additional clarification?

All feedback should be submitted through FSRA's website at [Consultation on the Proposed Enhancements to Liquidity Guidance](#) on or before December 2, 2020. FSRA requests that respondents from individual CUs consolidate their feedback from within their organization into one submission.

Scope

The amendments outlined in this consultation paper affect the following entities regulated by FSRA:

- Credit Unions and Caisses Populaires incorporated under the *Credit Union and Caisses Populaires Act, 1994* (CUCPA)

Rationale and Background

Promoting the safety and protection of CU liquidity and ensuring that CUs have reliable access to assets held for liquidity purposes is important in promoting the stability of the CU sector and protecting CU member deposits.

One of FSRA's priorities is to support the modernization of Ontario's CU regulatory framework. In support of this priority, FSRA is proposing amendments to the existing liquidity guidance. These amendments advise on minimum liquidity requirements and are designed to assist CUs in maintaining sufficient liquidity. Further, these proposed

amendments will advance FSRA's oversight capabilities over the prudent liquidity management practices of Ontario CUs.

These proposed amendments would support FSRA in fulfilling the following legislative objects set out under the *Financial Services Regulatory Authority of Ontario Act, 2016* (FSRA Act):

- To provide insurance against the loss of part or all of deposits with CUs;
- To promote and otherwise contribute to the stability of the CU sector in Ontario with due regard to the need to allow CUs to compete effectively while taking reasonable risk; and
- To pursue the above objects for the benefit of persons having deposits with CUs and in such manner as will minimize the exposure of the Deposit Insurance Reserve Fund to loss.

Principles

The proposed amendments to the liquidity guidance documents reflect the following principles:

1. Liquidity standards will be risk-based and applied in a proportional manner which takes into account the size, complexity and risk of a particular CU.
 - CUs continue to have the responsibility to determine adequate liquidity based on their specific business risks and exposures. Adequate liquidity should be set out in a CU's prudent liquidity policies.
2. The need for CUs to manage their day-to-day liquidity needs should be balanced with the need to be prepared to manage a liquidity stress.
 - Ensuring sufficient liquidity to manage a potential stress event should be managed by a CU without putting unreasonable strain on a CU's regular cash management activities and operations.

3. CU liquidity should be safeguarded from claims by third parties, readily available, and accessible on demand to meet potential unforeseen liquidity needs of the CU.
 - When the High-Quality Liquid Assets (HQLA) held by CUs to satisfy prudent liquidity requirements are managed by a third-party, those assets should be held in a structure that is bankruptcy remote and creditor proof from creditors of the third-party. CUs should ensure, and be satisfied that, their chosen structures are bankruptcy remote and creditor proof. This conclusion should be qualified by an external legal opinion and be made available to FSRA upon request.
4. CUs continue to have the responsibility to determine who manages their liquidity, as long as they hold adequate liquidity and adhere to prudent liquidity standards.
 - CUs should be able to choose their own service provider or manage their own liquidity, provided that they adhere to regulatory requirements and standards set out in FSRA guidance. The revised guidance will not mandate a specific liquidity service provider for CUs.
5. Standards will be neutral in their application to all Ontario CUs, regardless of liquidity service provider or membership in a central/ league.

Proposed Amendments

Statutory liquidity requirements for Ontario CUs are set out in sections 84 and 85 of the CUCPA and sections 21 to 23 of Ontario Regulation 237/09 (the Regulation). In accordance with such requirements, CUs must maintain adequate and appropriate forms of liquidity and have prudent liquidity policies in place.

FSRA's existing liquidity guidance interprets these statutory requirements by setting standards for CUs to follow when determining adequate and appropriate forms of liquidity. As well, the existing guidance outlines expectations for CUs as it relates to developing prudent liquidity policies. The guidance also outlines FSRA's approach to supervising against the requirements and standards, including reporting requirements.

FSRA is proposing amendments to the liquidity framework in the following five areas:

1. Liquidity Assets and Management

Amendments to the liquidity guidance documents are being considered to ensure that CUs can swiftly and reliably access their HQLA in order to manage unexpected liquidity needs. Such amendments would clarify the criteria for assets that may be included as HQLA and held by CUs for such purposes (i.e., that the assets be truly unencumbered). This includes characteristics of a structure designed to hold CU liquidity assets when managed by a third-party liquidity manager (e.g., a central or another financial institution).

The existing Completion Guide: Liquidity Coverage Ratio (2018) sets out that deposits held with Central 1 or a league are considered to be level 1 HQLA. Under the proposed amended guidance, such deposits would no longer qualify as HQLA, as these assets are unsecured senior claim on Central 1 or the league and are subject to risks that are not appropriate for HQLA. Rather, deposits in Central 1 or a league would be treated in a similar manner to deposits held with other financial institutions. Such deposits can be included as an inflow in the liquidity coverage ratio (LCR) calculation (if they are due within 30-days).

In addition, the updated guidance would set out that CUs that use third-party liquidity managers should ensure that the structure within which a CU's liquidity assets are held is such that the assets are bankruptcy remote and protected from the creditors of the third-party liquidity manager. Further, the assets should be available on demand in order to satisfy potential liquidity needs. A CU's HQLA should be owned by the CU and a third-party liquidity manager should only act as a custodian.

Therefore, while deposits held with Central 1 or a league would not be considered HQLA under the proposed amended guidance, HQLA that are managed by Central 1, or another liquidity manager, and are held in a structure that ensures that the assets are bankruptcy remote and protected from the creditors of the liquidity manager, would qualify as HQLA. A CU should ensure, and be satisfied that, its chosen structure within which its liquid assets are held is bankruptcy remote and creditor proof. This conclusion should be qualified by an external legal opinion and be made available to FSRA upon request.

FSRA is proposing that the amendments described above be effective as of January 1, 2021.

2. Liquidity Reporting Metrics

FSRA's two guidance notes on liquidity (Guidance Note: Liquidity and Guidance Note: Stress Testing – Credit Unions with Assets Greater than \$500 million) outline reporting metrics for CUs with assets greater than \$500 million. These metrics, consisting of minimum short-term and long-term liquidity ratios,¹ provide FSRA with the ability to monitor CU liquidity and intervene at an early stage if a liquidity issue arises.

CUs with assets greater than \$500 million are currently required to report on the following liquidity metrics:

1. Liquidity Coverage Ratio (LCR)² – Minimum Ratio of 100%³
2. Net Cumulative Cash Flow (NCCF)⁴ – No Minimum
3. Net Stable Funding Ratio (NSFR)⁵ – Minimum Ratio of 100%⁶

FSRA will not be proposing any changes to the liquidity reporting metrics for CUs with assets greater than \$500 million.

CUs with assets equal to or less than \$500 million are not currently required to report on any liquidity metrics. It is important that CU boards and management have transparent and reliable tools and data to maintain adequate liquidity. Further, as supervisor, FSRA would be better able to anticipate and respond to potential liquidity issues if it consistently receives information. Therefore, FSRA is proposing to amend the liquidity guidance documents to require that all CUs, including those with assets equal to or less than \$500 million, report their LCR to FSRA.

¹ These minimum ratios are a pre-stress minimum requirement and FSRA has the discretion to exercise forbearance during stress to allow a CU to operate at a lower level.

² See appendix IV for detailed information on the LCR

³ This minimum ratio is a pre-stress minimum requirement and FSRA has the discretion to exercise forbearance during stress to allow a CU to operate at a lower level.

⁴ See appendix V for detailed information on the NCCF

⁵ See appendix VI for detailed information on the NSFR

⁶ This minimum ratio is a pre-stress minimum requirement and FSRA has the discretion to exercise forbearance during stress to allow a CU to operate at a lower level.

LCR is recognized as a prudent measure of short-term liquidity under moderately stressed conditions. However, satisfying minimum LCR thresholds (or NSFR and NCCF for CUs with Assets Greater than \$500 million) alone do not necessarily mean that a CU is holding adequate liquidity. Each CU should be satisfied that they are holding adequate liquidity to meet both their short and longer-term liquidity obligations and be able to demonstrate this adequacy to FSRA. In that respect, CUs will need to identify what they consider to be adequate, and appropriate forms of liquidity based on their individual business and risk profiles.

To ensure CUs with assets equal to or less than \$500 million have adequate time to develop and implement LCR reporting, FSRA proposes that such implementation occur by June 1, 2021, with the first report submitted to FSRA by July 10, 2021. FSRA expects that such CUs will operationalize their LCR reporting as soon as practical. FSRA will request progress updates on the implementation of LCR reporting beginning in January 2021.

3. Liquidity Reporting Frequency

Under the existing liquidity guidance (Guidance Note: Liquidity and Guidance Note: Stress Testing – Credit Unions with Assets Greater than \$500 million), CUs with over \$500M in assets are required to report to FSRA quarterly on their LCR, NSFR and NCCF. Given that a CU's LCR is intended to provide the regulator with an indication of the CU's short-term liquidity position (i.e., over a 30 day period), quarterly reporting has limited usefulness in achieving that objective.

Therefore, FSRA is proposing to amend the existing guidance to increase the frequency of LCR reporting for all CUs from quarterly to monthly. The proposed amendments would require that credit unions submit a completed LCR report to FSRA within 10 days after the end of each month, to ensure the information provided is relevant to the CU's current liquidity position.

FSRA proposes that monthly LCR reporting begin by June 1, 2021, with the first monthly report due to FSRA by July 10, 2021. FSRA expects that CUs operationalize monthly LCR reporting as soon as practical. FSRA will request progress updates on the implementation of monthly LCR reporting beginning in January 2021.

4. Maintaining Accountability in Liquidity Management

The CUCPA, the Regulations and FSRA's existing liquidity guidance outline principles-based requirements for CUs to hold adequate, and appropriate forms of liquidity and maintain prudent liquidity policies. CUs, under the proposed amendments to FSRA's liquidity guidance, will continue to be responsible for determining what is adequate and prudent liquidity for their institution.

Currently, Ontario CUs that are members of Central 1 are contractually required to hold 6% of their assets as liquidity deposits in Central 1's Mandatory Liquidity Pool (MLP). This, along with the additional liquidity that CUs held, has been generally viewed as being adequate liquidity to meet the requirements set out in the legislative and guidance frameworks.

Central 1 has indicated that this contractual requirement will be terminated once it implements its new liquidity management structure by December 31, 2020.

Therefore, CUs should consider and determine what constitutes adequate and prudent liquidity for their institutions. CUs may determine that maintaining HQLA equal to 6% of assets under Central 1's new liquidity structure is still prudent and adequate. Conversely, CUs may conclude that a different level of liquidity or that a different metric/tool should be set out in their prudent liquidity policies. CUs would need to demonstrate that the level of liquidity they hold or metrics/tools utilized is adequate and prudent. CUs may wish to engage with their Relationship Managers as they review and potentially revise their prudent liquidity policies.

Ontario's liquidity framework does not require CUs to be members of a central or league, nor does it prescribed third-party liquidity managers. CUs are currently permitted to use a third-party liquidity manager of their choice, manage their own liquidity internally, or a combination of the two, provided that adequate, and appropriate forms of liquidity are maintained at all times. The proposed amendments to the liquidity guidance documents will continue to reflect that CUs are responsible for determining who manages the assets that they hold for liquidity purposes.

5. Housekeeping Edits

FSRA will propose general housekeeping edits throughout the liquidity guidance documents in order to remove and replace outdated references (e.g., updating titles of documents, replacing DICO with FSRA, and removing references to organizations that no longer exist). FSRA intends to re-issue the liquidity guidance documents as FSRA Interpretation and Approach guidance.

Compliance Expectations

FSRA's liquidity guidance documents set out FSRA's interpretation of the requirements under the CUCPA and the Regulation with respect to CU prudent liquidity management. Non-adherence may lead to enforcement or supervisory action by FSRA, including requiring remediation and reporting, and/or issuing orders and placing the CU under supervision or administration.

FSRA will monitor adherence to the principles and requirements as part of its supervisory approach. FSRA's supervision, and if required enforcement activities, will be carried out under the relevant provisions of the CUCPA, the Regulation and its general authority under the FSRA Act.

Appendix I – Specific Proposed Amendments to Liquidity Framework

Amendments are being proposed to the following guidance documents:

- Guidance Note: Liquidity Guidance (2018)
- Guidance Note: Stress Testing – Credit Unions With Assets Greater Than \$500 Million (2017)
- Liquidity Coverage Ratio Completion Guide (2017)
- Net Cumulative Cash Flow Completion Guide (2017)
- Net Stable Funding Ratio Completion Guide (2017)

The following table describes the specific proposed amendments that are being proposed to FSRA’s liquidity guidance documents.

#	Amendment	Rationale
Liquidity Assets and Management		

1 Sentence Removed – Completion Guide: Liquidity Coverage Ratio – Level 1 Assets
FSRA is proposing the following be removed from the Completion Guide: Liquidity Coverage Ratio under the section “Level 1 Assets”:

Liquidity Reserve Deposit with Central 1 or a League;

This proposed removal would promote the objective of ensuring that assets used to meet HQLA requirements are unencumbered and, when managed by a third-party, are held in a structure that is bankruptcy remote and protected from creditors of the third-party.

CU deposits that are currently held in the Central 1 MLP and transitioned to the new Central 1 trust structure will be considered HQLA, provided that the trust structure satisfies the principles set out in guidance (i.e., creditor proof & bankruptcy remote) and that the assets being held meet HQLA criteria, as set out in the guidance.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

2 Sentence Removed – Completion Guide: Net Stable Funding Ratio – Assets Assigned a 0% RSF factor
FSRA is proposing the following be removed from the Completion Guide: Net Stable Funding Ratio under the section “Assets Assigned a 0% RSF factor”:

Liquidity Reserve Deposit with Central 1 or a League;

See rationale for amendment 1

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)



**3 New Section – Guidance Note:
Liquidity Guidance**

FSRA is proposing the following be added to the Guidance Note: Liquidity Guidance:

Section Title: Bankruptcy Remote and Creditor Proof

Credit unions should ensure that their liquidity assets held and/or managed by a third-party liquidity manager are unencumbered, available on demand and held in a structure that is bankruptcy remote and creditor proof. For further clarity, this means that the liquidity assets of a credit union must not be subject to the claims of the creditors of a credit union’s third-party liquidity manager. This includes, but is not limited to, circumstances involving the insolvency, bankruptcy or winding-up of the third-party liquidity manager.

CUs should ensure and be satisfied that their liquidity assets held and/or managed by a third-party liquidity manager meet the above expectations. This conclusion should be qualified by an external legal opinion and be made available to FSRA upon request. The legal opinion should be updated as necessary because of, amongst other things, changes to applicable laws or structure.

This proposed new section would promote the safeguarding of CU liquidity assets when managed by third parties. It would ensure that creditors of a CU’s liquidity provider do not have access to such assets, so that there is assurance that they are available to a CUs if and when needed. This would improve the certainty that a CU can swiftly and reliably access liquidity in “business as usual” and crisis scenarios.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

4 New Sentence – Guidance Note: Liquidity – Assets Held for Liquidity
FSRA is proposing the following be added to the Guidance Note: Liquidity under the section “Assets Held for Liquidity”:

Credit unions should have unfettered and timely access to assets held for liquidity purposes.

This proposed new sentence is intended to ensure that a CU can quickly access their HQLA if needed suddenly and unexpectedly.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

5 New Paragraphs – Completion Guide: Liquidity Coverage Ratio – HQLA

FSRA is proposing the following be added to the Completion Guide: Liquidity Coverage Ratio under the section “HQLA”:

See rationale for amendment 3 & 4

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

7. Credit unions should ensure that their HQLA held and/or managed by a third-party who is acting as liquidity manager be available on demand, unencumbered, and held in a structure that is bankruptcy remote and creditor proof. For greater clarity, this means that the credit union’s assets held for liquidity purposes and managed by a third-party must not be subject to the claims of the creditors of that third-party, including in the circumstances of its potential insolvency, bankruptcy or winding-up.

8. A credit union’s management and board should ensure that the credit union has timely and unfettered access to its HQLA before leadership includes them in their LCR calculation.

Liquidity Reporting Metrics

6 **New Paragraph – Guidance Note: Liquidity – Stress Testing Metrics**

FSRA is proposing the following be added to the Guidance Note: Liquidity under the section “Stress Testing Metrics”:

CUs with assets equal to or less than \$500 million are required to adopt the LCR effective June 1, 2021. In addition, credit unions with assets equal to or less than \$500 million are expected to develop sufficient liquidity regimes to manage their short-term and long-term liquidity needs.

FSRA expects that all CUs operationalize monthly LCR reporting as soon as practical.

This proposed new paragraph would set out proportional liquidity reporting requirements for CUs with assets equal to or less than \$500 million, in order to ensure that FSRA can monitor liquidity for such CUs, be confident that they are able to manage unexpected liquidity needs, and identify potential issues at an early stage so that FSRA can work with the CU to address such issues.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

7 **Amended Section – Guidance Note: Stress Testing – Credit Unions With Assets Greater Than \$500 Million – Minimum Stress Testing Requirement**

FSRA is proposing the following changes be made to the Stress Testing – Credit Unions With Assets Greater Than \$500 Million under the section “Minimum Stress Testing Requirements”

In order to apply proportionality in minimum liquidity stress testing requirements, the liquidity metric reporting requirements for credit unions with greater than \$500 million in total

This proposed amended section would introduce the separation of requirements for CUs with assets greater than \$500 million and CUs with assets equal to or less than \$500 million.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

assets are different from those for credit unions with assets equal to or less than \$500 million.

Satisfying the minimum liquidity metrics do not necessarily mean that a credit union is holding adequate and prudent liquidity. Each credit union will have to determine what they consider to be adequate, and appropriate forms of, liquidity based on their individual business and risk profile and demonstrate that such determination is prudent.

The minimum ratios outlined throughout this guidance represent pre-stress minimum requirements and FSRA has the discretion to exercise forbearance during stress to allow credit unions to operate at a lower level.

The following sections outline the specific liquidity metrics for credit unions with total assets above \$500 million and for credit unions with assets equal to or less than \$500 million.

**8 New Section – Guidance Note:
Stress Testing – Credit Unions With
Assets Greater Than \$500 Million
- Credit Unions with Assets Less
than \$500 Million**

FSRA is proposing the following be added to the Stress Testing – Credit Unions With Assets Greater Than \$500 Million

**Section Title: Credit Unions with
Assets Equal to or Less Than \$500
Million**

Credit unions should develop liquidity regimes which take into account their size, complexity and risk. FSRA recognizes that the complexity of liquidity regimes will differ and proportional to the size, specific risks and business exposures of the credit union.

Stress Testing Metrics

To ensure that credit unions with assets equal to or less than \$500 million have a prudent tool to measure their ability to withstand a liquidity shock, they should complete an updated LCR template on a monthly basis, effective June 1, 2021.

Additionally, credit unions with assets equal to or less than \$500 million should maintain sufficient liquidity over a longer period to manage both “business as usual” and liquidity stress events.

This proposed new section would outline the minimum stress testing metrics for CUs with assets equal to or less than \$500 million.

The LCR was recognized as the most appropriate short-term metric to manage sudden liquidity needs. Additionally, the current data provided to FSRA during COVID-19 aligns with the LCR calculation and is not viewed as overly burdensome.

FSRA also recognized that CUs with assets equal to or less than \$500 million will need to monitor and manage their longer-term liquidity needs past the 30-day LCR stress test. FSRA’s view is that a principles-based solution would be most appropriate, requiring CUs with assets equal to or less than \$500 million to determine what they consider adequate and prudent long-term liquidity based on their specific business exposures and risk appetite.

While FSRA considered requiring CUs with assets equal to or less than \$500 million to report on the NSFR and NCCF, this option was considered burdensome and unnecessary.

FSRA may, as part of the more extensive changes to the liquidity framework, develop more formal long-term liquidity requirements for CUs with assets equal to or less than \$500 million.

Liquidity Coverage Ratio (LCR)

The LCR aims to ensure that a credit union has an adequate stock of unencumbered HQLA that consists of cash or assets that can be converted into cash at little or no loss in value to meet potential liquidity needs for a 30-calendar day liquidity stress scenario.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

FSRA expects that, at a minimum, the LCR should be no lower than 100% on an on-going basis such that the stock of unencumbered HQLA should enable the credit union to survive to Day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions will be taken by management and/or the supervisor, or that the credit union can be resolved in an orderly fashion.

Long-Term Liquidity Reporting

CUs with assets equal to or less than \$500 million should maintain adequate and prudent liquidity to manage their liquidity needs beyond the 30 days outlined in the LCR. Each credit union is expected to determine what they considered adequate and prudent long-term liquidity based on their specific business exposures and risk appetite, which should be outlined in their liquidity policies.

Credit union management should be able to demonstrate to their boards that they have adequate liquidity to manage their long-term liquidity needs under “business as usual” and stress

scenarios. As part of its regular supervisory process, FSRA will request evidence that credit unions have adequately liquidity to manage both short-term and long-term liquidity needs.

Completion Guides and Templates for the LCR are available on FSRA's website.

Credit unions with assets equal to or less than \$500 million should also consider incorporating more complex metrics such as the NSFR and NCCF into their stress testing program, particularly as the institution grows larger, more complex and approaches the \$500 million threshold.

Liquidity Reporting Frequency

9 New Paragraph – Liquidity Guidance – Stress Testing Metrics

FSRA is proposing the following be added to the Liquidity Guidance under the section “Stress Testing Metrics”:

All credit unions are required to submit to FSRA an updated LCR template within 10 days after the end of each month, beginning on June 1, 2021, with the first monthly report to be provided to FSRA by July 10, 2021. FSRA expects that all CUs operationalize monthly LCR reporting as soon as practical.

This proposed new paragraph is aimed at improving the usefulness of CU LCR reporting. It acknowledges that, given the short-term basis of LCR, quarterly reporting does not provide a meaningful indication of a CUs short-term liquidity position, which could impact the regulator's ability to work with a CU to address potential issues and provide support if needed.

With quarterly LCR reporting, FSRA does not receive a CU's 30-day liquidity metric until 3 months after such period has passed. As a result, the information provided is not reflective of the CUs current short-term liquidity

Prior to June 1, 2021, credit unions with assets greater than \$500 million are required to submit to FSRA an updated LCR template at the end of each calendar quarter. Additionally, credit unions with assets greater than \$500 million are required to submit to FSRA an updated NSFR and NCCF template at the end of each calendar quarter.

position.

Requiring this information within 10 days after the end of each month would increase the likelihood that the information is reflective of the CUs current liquidity position.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

10 Amended Section – Guidance Note: Stress Testing – Credit Unions With Assets Greater Than \$500 Million – Reporting

FSRA is proposing the following be added to the Stress Testing – Credit Unions With Assets Greater Than \$500 Million under the new section “Credit Unions with Assets Greater than \$500 Million”

Credit unions with assets greater than \$500 million are required to submit to FSRA an updated LCR template 10 days after the end of each month, beginning on June 1, 2021, with the first monthly report to be provided to FSRA by July 10, 2021. Prior to June 1, 2021, credit unions with assets greater than \$500 million are required to submit to FSRA an updated LCR template at the end of each calendar quarter.

FSRA expects that all CUs operationalize monthly LCR reporting as soon as practical.

See rationale for amendment 9 for LCR reporting

In recognition that the NSFR and NCCF are longer-term metrics, FSRA considers quarterly reporting on such metrics to be appropriate.

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

Additionally, credit unions with assets greater than \$500 million are required to submit to FSRA an updated NSFR and NCCF template at the end of each calendar quarter. Credit unions should be prepared to submit the NSFR and NCCF templates monthly when requested.

Reporting templates in Excel format are available on FSRA's website.

**11 New Section – Guidance Note:
Stress Testing – Credit Unions With
Assets Greater Than \$500 Million
– Reporting**

FSRA is proposing the following be added to the Stress Testing – Credit Unions With Assets Greater Than \$500 Million under the new section “ Credit Unions with Assets Equal to or Less than \$500 million ”

Credit unions with assets equal to or less than \$500 million are required to submit to FSRA an updated LCR template 10 days after the end of each month, beginning on June 1, 2021, with the first monthly report to be provided to FSRA by July 10, 2021.

Reporting templates in Excel format are available on FSRA's website.

See rationale for amendment 9

[\(Click Here to View Proposed Amendment in Corresponding Appendix\)](#)

Housekeeping Edits

- 12 Change to Guidance Name – Stress Testing Guidance**
FSRA is proposing that the name of the guidance note “Guidance Note: Stress Testing Guidance for Credit Unions with Assets Greater than \$500 million” be changed to “Guidance Note: Stress Testing Guidance”
- The stress testing guidance is proposed to be amended to apply to all CUs to reflect the need to have risk-based metrics for institutions of all sizes.
- 13 New Section Names – Stress Testing Guidance**
FSRA is proposing that the minimum stress testing requirements section name be split into the following two sections: (1) “Credit Unions with Assets Greater than \$500 Million” and “Credit Unions with Assets Equal to or Less Than \$500 million”
- The new proposed sections would be used to set out the different liquidity requirements based on total assets.
- 14 DICO Format Replaced with FSRA Format – Throughout**
FSRA is proposing that the DICO format for the guidance and completion guides be transferred to the FSRA interpretation and approach templates.
- The DICO format for guidance and completion guides has been replaced using FSRA’s Interpretation and Approach templates.
- Additional sections have been added to accommodate differences in the two templates; however, they do not include new or amended requirements for CUs.
- 15 DICO Replaced with FSRA – Throughout**
FSRA is proposing that references to DICO in the guidance documents be replaced with FSRA in all of the amended guidance documents.
- Outdated references to DICO have been replaced with references to FSRA, its successor organization.

16 Removal of References To Defunct Organizations – Throughout

FSRA is proposing that references to La Caisse centrale Desjardins du Québec or Credit Union Central of Canada be removed.

Reference to organizations that no longer exist have been removed.

Appendix II – Proposed Guidance Note: Amended Liquidity Guidance

Guidance



Effective Date: January 1, 2021

Identifier: No. CU0064INT/APP* *(previously listed as CU0036ORG)*

Liquidity Guidance

Purpose

This Interpretation and Approach Guidance provides an explanation of the fundamental concepts that form the basis for the responsibilities of the credit union, its management and its board in implementing effective liquidity policies and risk management practices to ensure the continued viability of the credit union in the best interest of its members. Additionally, this Guidance outlines FSRA's minimum expectations for the management of liquidity within a credit union. It sets out the criteria FSRA will use when evaluating the effectiveness of liquidity management practices.

FSRA considers proportionality in the application of this Guidance, including the structure, size and complexity and risk profile of the credit union, as well as the potential consequences of the credit unions failure, including the systemic impact.

Scope

This Interpretation and Approach Guidance affects the following entities regulated by FSRA:

- Credit Unions and Caisses Populaires incorporated under the *Credit Union and Caisses Populaires Act, 1994* (the Act).

This Guidance complements the information provided in, and should be read in conjunction with, other FSRA guidance and supporting publications available on FSRA's website (www.fsrao.ca).

Rationale and Background

This Guidance will promote prudent liquidity management in support of FSRA achieving its legislative mandate under the *Financial Services Regulatory Authority of Ontario Act, 2016* (FSRA Act), being:

- To provide insurance against the loss of part or all of deposits with credit unions;
- 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 risk; and
- To pursue the objects set out in the above two clauses 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.

Liquidity is the ability of a credit union to generate or obtain sufficient cash or its equivalents in a timely manner at a reasonable price to meet its commitments as they fall due. Liquidity risk arises from a credit union's potential inability to meet both expected and unexpected current and future cash flow and collateral needs without affecting daily operations or its financial condition. A credit union's obligations, and the funding sources used to meet them, depend significantly on its business mix, balance sheet structure, and the cash flow profiles of its on- and off-balance obligations. These include funding mismatches, market constraints on the ability to convert assets into

cash or in accessing sources of funds, and contingent liquidity events, such as finding additional funds for undrawn loan commitments or replacing maturing liabilities.

The Interpretation section of this Guidance outlines FSRA's principles for the liquidity policies and risk management practices at Ontario credit unions. This Guidance supplements other FSRA by-laws, rules, and guidance, and it should be read and interpreted in conjunction with other FSRA guidance, rules and applicable provisions of the Act and Ontario Regulation 237/09 (the Regulation).

The Approach section of this guidance describes how FSRA will assess Ontario credit unions' application of the principles set out in the Interpretation section. It is the responsibility of the Board and Senior Management of each credit union to obtain the necessary internal or external assistance or expertise (legal, financial, risk management, etc.) in the creation and maintenance of its liquidity policies, procedures and documents.

Throughout this Interpretation and Approach guidance:

- The term "Board" refers to either the entire Board of the credit union or a committee of the Board that has been delegated an element of Board oversight.
- The term "Senior Management" refers to the Senior Management of the credit union consisting of the Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, and any other member of the Senior Management team.

Interpretation

The legislative liquidity requirements detailed in section 84 and 85 of the Act and sections 21 to 23 of the Regulation require that credit unions maintain adequate and appropriate forms of liquidity and establish and adhere to liquidity policies. This guidance interprets these legislative requirements under the Act and Regulations in addition to outlining FSRA's approach to supervising against the standards, including reporting requirements.

Compliance Expectations

This guidance sets out FSRA's interpretation of the requirements under the Act and associated Regulations with respect to prudent liquidity management. Non-adherence may lead to enforcement or supervisory action by FSRA, including requiring remediation and reporting, and/or issuing orders and placing the credit unions under supervision or administration.

FSRA will monitor adherence to the principles and requirements set out in the interpretation section of this guidance as part of its supervisory approach, as outlined in the Approach section of this guidance below.

FSRA's supervision, and if required enforcement activities, will be carried out under the relevant provisions of the Act and its general authority under the FSRA Act.

Principles

FSRA has identified principles for liquidity management along which it will interpret the above noted requirements set out in the Act and Regulations. FSRA will use the principles set out below to determine whether such requirements are satisfied.

1. Liquidity Framework: Credit unions should establish comprehensive policies, practices and procedures for the management of their liquidity.

A comprehensive framework should include:

- a governance structure and Board-approved liquidity risk tolerance that is reflected in liquidity and funding policies, business strategies, reporting frameworks, and risk management and control functions;
- a liquidity management philosophy which sets out broad liquidity goals and objectives of the credit union;
- a liquidity policy that sets out all key elements of liquidity management, including targets, limits and diversification of funding sources;
- ongoing measurement, management and monitoring of assets held for liquidity purposes and funding requirements;
- liquidity testing metrics including analysis of changes to funding requirements under alternative scenarios; and
- a liquidity contingency plan to address liquidity requirements in stressed situations.

2. Liquidity Risk Management: Credit unions should develop strategies to manage liquidity risk under normal and stressed conditions.

A credit union should:

- maintain a liquidity risk management framework and controls to identify, measure, manage and monitor liquidity risk exposures under normal conditions;
- maintain structurally sound funding plans; and
- develop potential scenarios that stress liquidity levels and ensure liquidity sources and contingency funding plans continue to be adequate to meet highly unlikely but plausible scenarios.

The framework should reflect the structure, size, complexity and risk profile of the credit union as well as its liquidity risk exposures.

Approach

Processes and Practices

FSRA has developed this Approach to define the practices and procedures that it will employ when assessing the credit union's adherence with the principles set out in the previous section of this Guidance.

In accordance with the provisions set out in section 85 of the Act, FSRA may order a credit union to amend its liquidity policies if they are considered inadequate or imprudent and considers it necessary to protect the interests of members, shareholders or depositors or to ensure the financial security and integrity of the credit union. Under section 86 of the Act, FSRA may order a credit union to provide additional liquidity and in such forms and amounts as it may require where FSRA has obtained satisfactory evidence that one or more of the following criteria have been met:

- material non-compliance with the capital and liquidity requirements of By-law #5 and any guidelines or directives issued by FSRA;
- an abnormal event has occurred that may trigger, for example, demand for deposits, non-payment of loans etc.;
- significant concentration risk in the loan portfolio or composition of member deposits;
- low or declining levels of liquidity that may not adequately meet cash flow requirements;
- excessive borrowings, or insufficient borrowing capacity to meet business needs;
- plant closure or other significant economic event;
- high risk loans or investments identified during an examination;
- capital or liquidity insufficient to meet business risks that may not be fully captured under the risk weighted capital test (BIS); and
- any other situations which in the opinion of FSRA may have an adverse effect on liquidity.

Governance and Liquidity Risk Tolerance

The Board is ultimately responsible for setting the risk tolerance for liquidity risk and ensuring that it is effectively communicated so management understands the credit union's approach to managing the trade-offs between the risks taken and the potential benefits.

In addition, the Board should ensure that it:

- understands the nature of the credit union's liquidity risk and reviews the information necessary to maintain this understanding at least annually;
- establishes lines of authority and responsibility for managing the credit union's liquidity risk;
- effectively oversees management in the identification, measurement, monitoring and control of liquidity risk in accordance with its liquidity risk tolerance policy;
- understands and periodically reviews the credit union's plans and strategies for dealing with adverse liquidity events and potential stress situations; and
- understands the liquidity risk profiles of key subsidiaries, as appropriate.

Liquidity Management Philosophy

Adopting a liquidity management philosophy is an important first step in drafting liquidity policy. The philosophy sets out the broad goals and objectives of the credit union with regards to liquidity, as established by the Board. This philosophy governs all liquidity policy constraints and helps address new situations where policy does not yet exist. While goals and objectives will differ depending upon the business model and operating environment of the credit union, important principles of liquidity management should always address the following key issues:

- ensuring enough liquidity to guarantee the orderly funding of members' needs, operational expenses and all other obligations of the credit union; and
- providing a prudent cushion for unforeseen liquidity needs; and achieving an appropriate balance between investment security, liquidity and yield.

Liquidity Policy

Credit unions should establish and implement documented, sound and prudent liquidity and funding policies recommended by senior management that are, approved and reviewed at least annually by the Board. Liquidity policies should articulate the importance senior management places on liquidity and the credit union's liquidity goals and funding needs.

The choice of analytical tools and the level of sophistication of information systems should be commensurate with the structure, size, complexity and risk profile of the credit union, the range and stability of its funding sources and the extent to which external funding is needed to meet lending needs.

To be considered prudent, the liquidity policy will address:

- identification of potential risks that could impact liquidity and ensuring all cash outflow commitments (on- and off-balance sheet) are honoured on a daily basis by performing match and funds flow analysis;
- limits, targets and diversification of acceptable funding and borrowing sources both on and off balance sheet;
- target levels in aggregate and by type of high quality, unencumbered assets that are designated as held for liquidity purposes consistent with the credit union's risk tolerance;
- liquidity management contingency plans;
- maturity matching and/or hedging of large deposits;
- processes for determining, reviewing, approving and applying liquidity stress testing scenarios and related assumptions; and
- frequency, form and content of Board reporting.

In assessing a credit union's implementation of these business practices, attention will be paid to the content and frequency of reports by management and the internal audit review of compliance with Board-approved policies and controls.

General Policy Guidelines

Minimum operating liquidity levels should be established that provide a reasonable cushion to meet cash needs, even during periods of market volatility or stress and seasonal fluctuations. A target range for liquidity should be established to reflect the fact that too much liquidity has a negative effect on earnings. The target range for operating liquidity should also reflect expected operating needs based on analysis of at least two previous years' fluctuations, expected increases/decreases in loan demand, income requirements for the year, and any other known factors which may affect available liquidity.

Liquidity should be managed in a prudent manner and in full accordance with the requirements in policy. If variances from policy arise it is incumbent on management to put in place timely measures to correct the variance, including invoking the contingency funding plan as necessary, and to report such actions to the Board. In circumstances where the contingency funding plan proves to be inadequate during a liquidity event, policy should include a requirement for notifying the Regulator.

FSRA recognizes that credit unions both take deposits from and lend money to its members. Credit unions should focus on developing stable funding techniques and avoid reliance on short-term funding or any single form of funding that may not be reliable during time of stress or market disruptions.

Credit unions should establish limits to ensure that:

- Deposit liabilities are not to be unduly concentrated with respect to the:
 - individual person and connected persons;
 - type of deposit instrument;
 - term to maturity; and
 - market source of funds, if applicable.

- Borrowings and other funding sources are not to be unduly concentrated with respect to the:
 - source and type of obligation/funding source; and
 - term to maturity.

When setting liquidity target and limit ratios, and assessing liquidity adequacy in accordance with this Guidance, each credit union should consider all sources and types of funding including obligations related to on- and off-balance sheet securitizations in any form (residential, commercial, asset backed, leases etc.). For the purposes of calculating FSRA's standard liquidity ratio for regulatory reporting purposes, all obligations that mature or become due within the next twelve months should be included in the denominator.

Adequate measuring, monitoring and reporting on the credit union's liquidity risk levels and exposures should be maintained. It is recommended that liquidity needs should be reviewed no less frequently than monthly⁷.

This review should encompass a detailed forecast of imminent liquidity requirements and a broad projection of cash needs for the next three-month period. The use of liquidity management tools should be outlined in the liquidity policy. When liquidity declines below the mid-point of the target range set by the credit union in their liquidity policy, the frequency of the reviews should increase.

Summary analysis of the various measurements of liquidity should be prepared for Board review at each Board meeting.

Annual Business Plan

The following information should be included as part of the annual business plan:

- a) Projected volume of operational liquidity, excess liquidity, seasonal liquidity increments, liquidity borrowings and average yield on liquid assets. This information can be combined with the monthly projections developed for asset/liability management planning. The plan will include narrative on actions and strategies designed to meet budget expectations.

⁷ Larger credit unions should consider more frequent monitoring as appropriate.

- b) Estimates of the dollar volume and ratios of operating and excess liquidity. The projections of the plan will be made at least monthly basis. This information can be combined with the asset/liability management projections in the annual business plan.

Measuring, Managing and Monitoring Liquidity

A sound framework for identifying, measuring, managing and monitoring sources and uses of liquidity and the commensurate risk should have several dimensions including:

- a comprehensive liquidity measurement program that is integrated within the liquidity management strategy and contingency funding plan of the credit union.
Components of such a program should include the combination of:
 - a process for accurately measuring and reporting pro-forma funding requirements through the projection of contractual and contingent cash flows;
 - maintenance of a stock of high-quality unencumbered liquid assets that can be converted under stress conditions into cash without incurring undue losses;
- a contingency funding plan that addresses liquidity stress testing outcomes;
- processes for:
 - internal limit setting and monitoring and reporting controls consistent with the credit union's risk tolerance;
 - measuring business performance and maintaining proper incentives for individual business lines to ensure they are assigning a liquidity cost or benefit to different business activities;
 - managing access to a diversified set of funding sources and maturities;
- information system requirements and the necessary personnel with the appropriate expertise to ensure timely measuring, monitoring and reporting of liquidity positions against limits to senior management and the Board to support appropriate action and oversight.

Assets Held for Liquidity

Section 21 of the Regulation outlines the requirements for adequate liquidity for credit unions. Section 84 of the Regulations requires that the types of assets held for liquidity purposes are identified in the financial statements of credit unions.

Assets held for liquidity should consist of cash and high quality securities for which there is a broad and active secondary market where these assets can be liquidated through their sale to a wide range of counterparties without incurring a loss that cannot be supported by current levels of capital, thereby securing their status as dependable sources of cash flow. The purpose of these assets is to provide the credit union with time to access alternative sources of funding in the event that circumstances giving rise to a liquidity problem arise. For the purposes of liquidity management, cash can only be included in the assets held for liquidity when the currency is in the possession of, owned by and under the direct control of the credit union. Examples include cash in the form of Bank of Canada currency in the credit union's care custody and control (e.g. vault, teller's drawers or ATMs owned and operated by the credit union).

Credit unions should have unfettered and timely access to assets held for liquidity purposes. When determining which assets can be included in assets held for liquidity, the credit union's policies should also consider the existence of impediments that would prevent a quick sale to meet unanticipated net cash outflow requirements.

Under section 22 of the Regulation, an encumbered asset cannot be used to satisfy the requirements for adequate liquidity except where the asset is encumbered by a security interest in favour of FSRA.

Assets held for liquidity may not include assets pledged to leagues and other financial institutions as security for the provision of clearing and settlement functions. When establishing the minimum targets for assets held for liquidity, a credit union should consider its overall liquidity profile including factors such as asset quality, stability of funding sources, cost and diversity of funding, short-term funding requirements.

Bankruptcy Remote and Creditor Proof

Credit unions should ensure that their liquidity assets held and/or managed by a third-party liquidity manager are unencumbered, available on demand and held in a structure that is bankruptcy remote and creditor proof. For further clarity, this means that the

liquidity assets of a credit union must not be subject to the claims of the creditors of a credit union's third-party liquidity manager. This includes, but is not limited to, circumstances involving the insolvency, bankruptcy or winding-up of the third-party liquidity manager.

CUs should ensure and be satisfied that their liquidity assets held and/or managed by a third-party liquidity manager meet the above expectations. This conclusion should be qualified by an external legal opinion and be made available to FSRA upon request. The legal opinion should be updated as necessary because of, amongst other things, changes to applicable laws or structure.

Borrowings and Other Funding

In situations of liquidity shortages, credit unions may need to borrow funds to meet liquidity needs. When doing so, the credit union needs to be aware of regulatory limits on borrowings and on the creation of security interests. Under section 183 of the Act, a credit union may not borrow more than 50% of the credit union's regulatory capital and deposits. Under subsection 48 (3) of the Regulation, a credit union may only grant a General Security Agreement (GSA) where the debt is owed to a league, Central 1 Credit Union or La Fédération des caisses Desjardins du Québec. The GSA must include a provision permitting its assignment to the FSRA under the circumstances set out in s.48 (4) of the Regulation.

Under no circumstances may security be granted over assets identified as assets held for liquidity.

Collateralized Borrowing

Under subsection 48(3) of the Regulations, a credit union may, under certain conditions, borrow an aggregate amount up to 15% of its total assets secured by a fixed charge against identified assets.

Securitizations

FSRA recognizes securitization as a valuable funding tool as part of a diversified funding strategy. FSRA expects that credit unions understand the risks inherent in securitizations and ensure these risks are prudently mitigated. Credit unions should not become overly reliant on securitizations to the point where changes in future availability would have a negative impact on their liquidity or capital positions.

Credit unions may enter into a variety of securitization transactions in order to fund loans and to provide liquidity for general use. When assessing the adequacy of liquidity and liquidity governance practices, FSRA expects that the Board establishes appropriate and prudent limits on the aggregate amount of each type of securitization, whether or not the balances are recorded on- or off-balance sheet under IFRS. Credit unions are expected to identify risks and implement prudent risk management practices to mitigate risk associated with their securitization programs. Credit unions should develop comprehensive liquidity plans and contingency funding plans that appropriately address the short-term and long-term liquidity risk associated with their securitization transactions. Credit unions should ensure a reasonable cushion for additional short-term emergency borrowing in times of liquidity shortfalls. In FSRA's evaluation of the credit union's ability to undertake securitization transactions, FSRA will evaluate, at a minimum:

- the degree to which the use of securitization is commensurate with the credit union's level of sophistication and knowledge of the risks;
- the effectiveness of policies and procedures, including limits, in place to properly manage the securitization programs;
- the Board's involvement and understanding of the credit union's securitization activities;
- the extent to which the risks of securitization are contemplated at a strategic level.

FSRA's expectations of the credit union and the level of scrutiny will increase as the size and complexity of the securitization program increases.

Credit unions will be required to submit their annual funding plan to FSRA at the beginning of their fiscal year. If circumstances change during the year and funding requirements deviate significantly resulting in the potential for more risk to the organization, an updated funding plan should be filed with FSRA.

Asset Sales

A credit union can sell assets to third parties to raise funds in a liquidity event; however, the credit union should be aware that under a liquidity event third party buyers of assets may be unable to purchase assets. Therefore, only asset sales which can be completed under a liquidity event should be considered as a funding source. Where

15% or more of the assets of a credit union are being sold, the transaction must be approved by FSRA pursuant to section 204 of the Act.

For an asset to be considered as liquidity, credit unions should be able to historically demonstrate the ability to sell assets through actual sales on a regular basis. The difficulties that can arise in asset sales in distressed situations, for example, lower pricing for the assets and prolonged settlement processes, should be fully factored into the contingency funding plan.

Large Deposits

Credit unions that rely on a significant number of large deposits have a higher risk of volatility in their liquidity levels than those whose deposit base consists of many smaller sized accounts. The withdrawal of large deposits due to either interest rate competition or members' investment discretion can significantly reduce liquidity and the credit union should consider setting limits in their liquidity policy. The policy should also require the identification and monitoring of deposits held by a member that are over a certain size and may require a "notice period" before the withdrawal of large deposits can be made.

When defining large deposits, the credit union may want to distinguish between large institutional or wholesale deposits and large retail deposits. For the purposes of defining large deposits, all deposits by connected and related entities should be aggregated. Policy should require the appropriate maturity matching of any large deposits and would generally require higher liquidity levels based on the concentration of large less stable deposits.

Operational Procedures

Procedures should address how liquidity needs are to be monitored and how to deal with liquidity shortages or excesses.

Monitoring Liquidity Needs

Liquidity needs should be reviewed on a periodic basis, but not less frequently than monthly. This review should encompass a detailed forecast of imminent liquidity requirements.

Summary measurements and analysis of liquidity needs should be prepared for Board review at each Board meeting. To determine immediate cash flow needs, a cash flow statement can be used to develop projections for the next three months. Periodic (weekly or monthly) cash flow projections can predict whether excess or deficient liquidity levels will be experienced by the credit union in the near future.

If there is a projected shortfall, management will need to take action to correct these levels. This action plan should be presented for approval by the Board.

Funding Requirements

Analyzing funding requirements involves the construction of a maturity ladder of assets and liabilities and the calculation of a cumulative excess or shortfall of funds at selected maturity dates. A credit union's funding requirements are determined by examining its future cash flows based on the future behaviour of assets and liabilities and off-balance sheet items including interim cash flows or settlements of financial derivatives, and then calculating the cumulative excess over the time frame for the liquidity assessment.

Assessing the funding surplus/shortfall requires consideration of, among other things:

- the amount of readily cashable assets held for liquidity relative to the surplus/shortfall;
- the size of the surplus or shortfall relative to total funding;
- the diversity of funding sources; and
- the quality of assets.

Liquidity Testing

Evaluating whether a credit union is sufficiently liquid depends greatly on the behaviour of cash flows under different conditions using a number of different approaches including sensitivity, scenario, and stress testing.

Sensitivity and scenario testing should be among the measurement techniques used by all credit unions as part of a robust contingency planning process and should include liquidity requirements for all subsidiaries.

Sensitivity testing typically involves an incremental change in a risk factor (or a limited number of risk factors). Scenario testing uses a hypothetical future state and changes

in risk factors affecting a credit union's operations. This considers changes to a number of risk factors, as well as possible ripple effects and impacts that follow logically from these changes. Stress testing is a more comprehensive risk management technique used to evaluate the potential short term and longer term impacts on a credit union's financial condition from exceptional but plausible events, and to attempt to determine the impact of situations where the assumptions used in managing a business break down. Stress testing includes an assessment of all risk factors using consistent criteria and assumptions for defined stress conditions.

Scenarios tested should include, at a minimum, a credit union's "going concern" condition and an unexpected specific disruption. The going concern scenario establishes a benchmark for the "normal" behaviour of balance sheet-related cash flows in the ordinary course of business. A liquidity disruption that remains confined to the credit union itself provides one type of "worst case" benchmark. Under each scenario, a credit union would try to include any significant swings in cash flows and funding requirements.

Liquidity testing requires a credit union to make assumptions about the probable behaviour of the timing of cash flows for each type of asset and liability under the conditions being examined.

For example, this may include developing assumptions for various funding sources and whether the liability would be:

- paid in full at maturity;
- gradually run off over the next few weeks; or
- virtually certain to be rolled over.

The uncertainties involved in making such estimates should reflect a conservative bias toward assigning later dates to cash inflows and earlier dates to cash outflows.

Credit unions are expected to create at least one scenario that results in a liquidity position that requires the activation of their contingency funding plan.

Stress Testing Metrics

All credit unions are expected to develop comprehensive liquidity testing programs that consider multiple scenarios of varying degrees of stress and time horizons as set out in the “Guidance Note: Stress Testing”.

The Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR) and Net Cumulative Cash Flow (NCCF) are standardized metrics introduced by BCBS⁸ and adopted by regulatory bodies in Canada including OSFI and credit union regulators to help measure, monitor and manage the level of liquidity at financial institutions beyond the simple liquidity ratio under minimum specified stress assumptions. Credit unions with assets greater than \$500 million are required to adopt these metrics effective December 31, 2017.

CUs with assets equal to or less than \$500 million are required to adopt the LCR effective June 1, 2021. In addition, credit unions with assets equal to or less than \$500 million are expected to develop sufficient liquidity regimes to manage their short-term and long-term liquidity needs.

All credit unions are required to submit to FSRA an updated LCR template within 10 days after the end of each month, beginning on June 1, 2021, with the first monthly report to be provided to FSRA by July 10, 2021. FSRA expects that all CUs operationalize monthly LCR reporting as soon as practical.

Prior to June 1, 2021, credit unions with assets greater than \$500 million are required to submit to FSRA an updated LCR template at the end of each calendar quarter.

Additional information on the stress testing metrics can be found in the “Guidance Note: Stress Testing” on FSRA’s website.

Assessing Liquidity Testing Results

The outcomes of the liquidity testing should be compared against the stated risk tolerance of the credit union; integrated into management decisions including limit setting and internal pricing systems; and incorporated into the design of contingency funding plans, including the determination of action plans allowing for the rapid

⁸ Basel Committee on Banking Supervision

escalation of information and implementation of a coordinated response by the credit union under a stress scenario.

The extent and frequency of liquidity testing should be commensurate with the structure, size, complexity and risk profile of the credit union and its liquidity risk exposures. Credit unions should build in the capability to increase the frequency of tests in special circumstances, such as volatile market conditions.

Liquidity testing results and any subsequent actions are to be reported to and discussed with the Board and integrated into the credit union's strategic planning process and day-to-day risk management practices. Testing results should also be a key consideration when establishing internal limits and assessing impacts on operations and other risks of the credit union as well as assessing and planning for related potential funding shortfalls in the credit union's contingency funding plan. When projected funding deficits are larger than (or projected funding surpluses are smaller than) the credit union's liquidity risk tolerance, management should consider, in consultation with the Board, whether to:

- adjust the operational plans to cope with the situation;
- adjust the credit union's liquidity position; or
- bolster the contingency funding plan.

The duration (temporary or permanent) of the funding issue will influence the steps taken to address the situation.

A critical element of a credit union's resilience to liquidity stress is the continuous availability of an adequate cushion of unencumbered, high-quality liquid assets that can be used to support a range of alternative scenarios. Credit unions must determine how much liquidity needs to be maintained (within the Board approved range) and demonstrate that their liquidity position is adequate. The size of the liquidity cushion is expected to be aligned with the risk tolerance and risk profile of the credit union.

Credit unions should ensure that its cushion of liquid assets is sized to maintain sufficient resilience to unexpected stress while it continues to meet daily payment and settlement obligations on a timely basis during the period of stress. Credit unions should

hold a core of the most liquid assets, such as cash and government securities, to protect against the most severe of stress scenarios.

To protect against less intense, but longer duration stress events, the composition of the liquidity cushion may be widened to hold other unencumbered liquid assets that are marketable without resulting in excessive losses or discounts. The marketability of individual assets may differ depending on the stress scenario and timeframe involved. Credit unions should not assume that a liquid market will exist for assets held during stress scenarios because a market exists in normal times.

Managing Market Access

For credit unions that participate in the financial markets, the funding strategy should provide effective diversification in the sources and duration of funding. It should ensure an ongoing presence in its funding markets and strong relationships with funds providers are maintained to promote effective diversification of funding sources.

A credit union should regularly gauge its capacity to raise funds quickly from each source. It should identify the main factors that affect its ability to raise funds and monitor those factors closely to ensure estimates of fundraising capacity remain valid.

As a check for adequate diversification of liabilities, a credit union needs to examine the level of reliance on individual funding sources by instrument type, etc. and set internal limits on the maximum amount of funds it will accept in the normal course from any one counterparty or any one funding market (e.g., deposit brokers, securitization or commercial paper) that is approved and monitored by the Board.

Developing markets for asset sales or exploring arrangements under which a credit union can borrow against assets is an important element of managing market access. The frequency of use of some asset-sales markets and the size and scale of the use of this funding is a possible indicator of a credit union's ability to execute sales under adverse scenarios.

Contingency Funding Planning

FSRA expects all credit unions to develop a formal contingency funding plan (CFP) that clearly sets out the strategies for addressing liquidity shortfalls.

A contingency funding plan is a compilation of policies, procedures and action plans for responding to severe disruptions to a credit union's ability to fund some or all of its activities in a timely manner and at a reasonable cost. A credit union's ability to withstand a liquidity funding disruption may also depend on the calibre of its contingency funding plans.

A CFP should outline policies to manage a range of stress situations, establish clear lines of responsibility, include clear invocation and escalation procedures and be regularly tested and updated to ensure that it is operationally robust. The CFP should be reviewed quarterly and changes made to ensure that it properly addresses any and all risks to the credit union's liquidity as the result of their liquidity forecasting models.

Effective contingency funding plans consist of several components, including:

- a set of early warning indicators designed with the aid of liquidity testing results that identify the emergence of increased risk or vulnerabilities to a credit union's liquidity position or potential funding needs and, if necessary, initialize the application of the CFP;
- specific procedures to ensure timely and uninterrupted information flows to senior management; clear division of responsibility within management in a crisis;
- action plans for altering asset and liability behaviours (e.g., market assets more aggressively, sell assets intended to hold, raise interest rates on deposits);
- an indication of the priority of alternative sources of funds (e.g., designating primary and secondary sources of liquidity);
- closer, more frequent monitoring of the effectiveness of action plans; and
- plans and procedures for dealing with media inquiries, notifying the Regulator and informing credit union members, as necessary.

Contingency funding plans should also include procedures for making up cash flow shortfalls in emergency situations. Credit unions have several sources of such funds available to them, including unused credit facilities. The plan should spell out, as clearly

as possible, the sources and amount of funds the credit union expects to have available from each source.

The development and ongoing maintenance of CFPs should be integrated within the credit union's program for testing liquidity risk. In other words, potential action plans outlining the process for the escalation of the CFP can come from the output of liquidity testing scenarios and, further, if a scenario is designed where the CFP would need to be invoked, then assumptions should reflect this.

CFPs are expected to be reviewed, tested and updated regularly (at least quarterly) to ensure effectiveness and operational feasibility, with the results of such tests reported to senior management regularly and to the Board as required.

Internal Controls and Incentives

Credit unions should have information systems in place that allow senior management and the Board to:

- review compliance with established liquidity risk management policies;
- control liquidity risk exposure; and
- evaluate risk tolerance through the use of limits, funding targets and early warning indicators.

The limit setting and compliance framework(s) should be calibrated to the results of the credit union's liquidity testing programs with the goal of being able to continue as a going-concern. Limits should be operationally effective and appropriately calibrated in accordance with the credit union's stated liquidity risk tolerance (i.e., not set so high that they are never triggered).

Clearly articulated and documented policies should describe procedures for:

- dealing with limit exceptions, permissions or authorization to set and change limits;
- notification responsibilities and escalation procedures;
- sign-off by senior management and/or the Board; and
- remedial follow up.

In order to ensure the integrity of information reporting, credit unions should establish a framework whereby monitoring of performance against limits is conducted by parties that are operationally independent of funding areas and other business units. Such personnel should be trained and have the information system capabilities to monitor whether liquidity risk remains within the bounds set by senior management and the Board. This framework is expected to be reviewed regularly as part of the general internal audit process.

For purposes of measuring business performance and maintaining proper incentives, credit unions are expected to have the capacity to assign a liquidity cost or benefit to different business activities, including new products, in terms of funding requirements, risks or provisions. These costs and benefits should be explicitly attributed to the relevant activity and reinforce the overarching liquidity risk tolerance of the credit union, with a liquidity charge assigned as appropriate to positions, portfolios or individual transactions.

This assignment of liquidity costs and benefits should incorporate factors related to the anticipated holding periods of assets and liabilities, their market liquidity risk characteristics and any other relevant factors. Further, in designing new products, a reputation assessment should be made of potential draws beyond contractual and/or legal obligations and potential impacts priced directly into a product.

Disclosure

Assets held for liquidity are required to be disclosed in the financial statements of the credit union. It is also recommended that information regarding the management of liquidity including policy limits, actual liquidity levels and trends etc. are also included to the extent appropriate for the size and complexity of the credit union. This should include the total amount of assets held for liquidity expressed as a percentage of total deposits and borrowings. Unencumbered and encumbered liquid assets should be separately reported.

The results of the LCR base case scenario should be included in management's discussion and analysis portion of the financial statements.

FSRA Assessment Process

As part of its on-going review process, FSRA undertakes an assessment of the inherent risks within each significant activity undertaken by a credit union and evaluates the quality of risk management which includes an assessment of the credit union's liquidity management practices.

As part of FSRA's overall assessment, FSRA will consider:

- the extent and quality of analysis applied;
- the level of conservatism in the internal estimates of the risks faced by the credit union;
- the extent that material risks are fully captured by the credit union, including both credit union specific and market events;
- the diversification of funding sources and the setting of limits on individual sources;
- the extent and quality of liquidity testing programs, tools and techniques, and the reasonableness of assumptions used;
- contemplation of the extent to which access to different funding sources is correlated in time of stress
- the extent of contingency funding planning; and
- the form and content of Board reporting including discussion and analysis of liquidity testing outcomes and trends, and material concentrations of funding sources and obligations.

This assessment will also form part of FSRA's examination criteria when considering the quality of liquidity management policies and practices.

Effective Date and Future Review

This decision became effective on January 1, 2021 and will be reviewed no later than January 1, 2024.

About this Guidance

This document is consistent with [FSRA's Guidance Framework](#). As Interpretation Guidance, it describes FSRA's view of requirements under its legislative mandate (i.e. legislation, regulations and rules) so that non-compliance can lead to enforcement or supervisory action. Approach Guidance describes FSRA's internal principles, processes and practices for supervisory action and application of Chief Executive Officer discretion. Approach Guidance may refer to compliance obligations but does not in and of itself create a compliance obligation. Visit [FSRA's Guidance Framework](#) to learn more.

Appendix III – Proposed Guidance Note: Amended Stress Testing Guidance

Guidance

<input type="checkbox"/> Interpretation	<input checked="" type="checkbox"/> Approach	<input type="checkbox"/> Information	<input type="checkbox"/> Decision
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Effective Date: January 1, 2021

Identifier: No. CU0065APP* *(previously listed as CU0038ORG)

Stress Testing Guidance

Purpose

This Approach Guidance outlines FSRA’s expectations with respect to stress testing and outlines how FSRA will assess the credit union’s risk management, business planning, and capital and liquidity management processes. Additionally, this Guidance outlines FSRA’s minimum expectations for stress testing within a credit union and sets out the criteria FSRA will use when evaluating the effectiveness of such.

FSRA considers the principle of proportionality in the application of this Guidance, including the structure, size and complexity and risk profile of the credit union, and the potential consequences of the credit union’s failure, including the systemic impact.

Scope

This Approach Guidance affects the following entities regulated by FSRA:

- Credit Unions and Caisses Populaires incorporated under the *Credit Union and Caisses Populaires Act, 1994* (the Act)

This Guidance complements the information provided in, and should be read in conjunction with, other FRSA guidance and supporting publications available on FSRA's website (www.fsrao.ca).

Rationale and Background

Stress testing is a risk management technique used to evaluate the potential effects on a credit union's financial condition from exceptional but plausible events, and to attempt to determine the impact of situations where the assumptions used in managing a business break down.

Stress testing plays an important role in:

- providing forward-looking assessments of risk
- complementing existing risk management models
- improving capital and liquidity planning purposes
- aiding the board in setting the risk appetite of the credit union
- facilitating the development of risk mitigation or contingency plans

Stress testing alerts a credit union to adverse, unexpected outcomes related to a variety of risks and provides an indication of how much capital might be needed to absorb losses should shocks occur. It is particularly important after extended periods of economic stability, when complacency can lead to the under-pricing of risk. Stress testing techniques include scenario analysis, sensitivity analysis and reverse stress testing, which are described in Appendix 1.

This Approach Guidance describes how FSRA will assess Ontario credit unions' stress testing policies, procedures and documents. It is the responsibility of the Board and Senior Management of each credit union to obtain the necessary internal or external assistance or expertise (legal, financial, risk management, etc.) in the creation and maintenance of its stress testing policies, procedures and documents.

Throughout this Approach guidance:

- The term “Board” refers to either the entire Board of the credit union or a committee of the Board that has been delegated an element of Board oversight.
- The term “Senior Management” refers to the Senior Management of the credit union consisting of the Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, and any other member of the Senior Management team.

Principles

FSRA has identified principles for assessing the effectiveness of a credit union’s stress testing policies, procedures and documents.

- 1. Diversity of Perspectives: Stress testing programs should take account of views from across the credit union and should cover a range of perspectives and techniques.**

The identification of relevant stress events and the appropriate use of stress testing results each require the collaboration of subject matter experts within the credit union. Credit unions should also use a range of techniques in order to achieve comprehensive coverage in their stress testing program, including quantitative and qualitative techniques to support and complement models and to extend stress testing to areas where effective risk management requires greater use of judgement.

- 2. Effective Governance: Credit unions are expected to have policies and procedures governing the stress testing program. The operation of the program should be appropriately documented.**

The assumptions and fundamental elements for each stress testing exercise should be appropriately documented, including the rationale for the scenarios chosen. The level of documentation should be based on the nature and purposes of the stress testing. For example, documentation of ad hoc sensitivity tests for tactical decisions may be less elaborate than the documentation of enterprise-wide stress tests used for strategic decision-making. An evaluation of fundamental assumptions should be

performed regularly or in light of changing external conditions. The results of the assessments should also be documented and reviewed periodically, as appropriate.

- 3. Flexible and Current:** Credit unions are expected to have an appropriate stress testing infrastructure in place, which is sufficiently flexible to accommodate different and possibly changing stress tests.

The credit union's stress testing infrastructure and information systems should reflect the structure, size, complexity and risk profile of the credit union and be able to aggregate comparable risks and exposures across the credit union where appropriate. It should allow for regular reporting to Senior Management and the Board in a timely manner throughout the fiscal year, and be sufficiently flexible to accommodate a timely increase in the frequency and number of ad hoc sensitivity tests to support Senior Management's response to changes in the environment.

- 4. Independent and Robust Testing:** Credit unions should maintain and update their stress testing framework. The effectiveness of the stress testing program, as well as the robustness of individual components, should be assessed regularly and independently.

Assessments of effectiveness should be qualitative and quantitative. Areas for assessment should include a review of the effectiveness of the program in meeting its intended purposes, documentation, data quality, assumptions used and board and management oversight. In particular, there should be independent review (e.g., internal audit) of the design and effectiveness of the credit union's stress testing program.

Approach

Processes and Practices

Stress testing should be embedded in enterprise-wide risk management and should be integrated into the credit union's strategic and business planning process and Internal Capital Adequacy Assessment Process ("ICAAP"). Results of stress testing should feed into the decision-making process, including setting the credit union's risk appetite, setting exposure limits and capital targets, and evaluating strategic choices in longer term business planning.

A credit union's stress testing program should serve the following purposes:

Supporting Capital Management

Stress testing should form an integral part of a credit union's ICAAP and used to identify severe events or changes in market conditions that could adversely impact the capital position of the credit union.

Risk Identification and Control

Stress testing should be included in a credit union's risk management activities. In particular, it should be used to address all material enterprise-wide risks, and consider the concentrations and interactions between risks in stress environments that might otherwise be overlooked. Stress testing also plays an important role in developing risk mitigation or contingency plans across a range of stressed conditions.

Providing a Complementary Risk Perspective to Other Risk Management Tools

Stress tests should complement other risk management tools that are often based on quantitative models using backward looking data and estimated statistical relationships. They provide future looking insights into the usefulness and validity of financial and risk management tools used by the credit union.

Stress testing allows for the simulation of potential shocks or changes in the economic environment, which may not have previously occurred, and helps to detect

vulnerabilities. These may include risk concentrations or potential interactions between types of risk that could threaten the viability of the credit union but may be overlooked when relying solely on statistical risk management tools based on historical data.

Improving Liquidity Management

Stress testing is key tool for identifying, measuring and controlling liquidity risks. Stress testing helps in assessing a credit union's liquidity profile and the adequacy of liquidity buffers in case of both credit union-specific and market-wide stress events.

It is important that credit unions continually monitor the environment and be cognizant of events that may trigger a liquidity event, and have appropriate contingency plans in place to deal with such an occurrence.

FSRA's Expectations

Credit unions are expected to be able to demonstrate and provide evidence that stress testing has been incorporated into their risk management, business planning and capital and liquidity management processes.

The nature and extent of stress tests should be appropriate for the size, structure, complexity and risk profile of the credit union. Stress test assumptions should be documented and supported by appropriate rationale.

Role of the Board and Senior Management

Board and Senior Management involvement in the stress testing program is essential. The Board has ultimate responsibility and oversight of the stress testing program and should:

- be aware of the key findings from stress tests, including the potential impacts of stress events on the risk profile of financial condition and risk profile of the credit union; and
- ensure that the credit union has established and implemented policies addressing stress testing requirements that are enterprise-wide and that stress testing is appropriately used as a risk management tool.

Senior Management is accountable for the program's implementation and for ensuring that the credit union has adequate plans to deal with remote but plausible stress scenarios.

Senior Management should:

- be able to identify and clearly articulate the credit union's risk appetite and understand the impact of stress events on the risk profile of the credit union;
- participate in the review and identification of potential stress scenarios, as well as contribute to the development and implementation of risk mitigation strategies; and
- consider a number of appropriate, well-understood, documented, utilized and sufficiently severe scenarios that are relevant to their credit union.

Development of a Stress Testing Program

Stress tests should cover a range of material risks across all key business areas of the credit union. A credit union should be able to effectively integrate its stress testing activities to produce a complete picture of the significant risks facing the credit union. Stress testing programs should examine the effect of shocks across all material and significant risk exposures facing the credit union.

Where relevant and material, such risks may include:

- credit risk
- concentration risk
- market risk, including:
 - general market
 - specific
 - cash flow mismatch
 - interest rate
 - foreign exchange
- liquidity risk
- contagion risk
- securitization risk
- operational risk
- other risks (e.g., strategic, reputation, legal)

The impact of stress tests is usually evaluated using one or more measures. Typical measures used are:

- required and available regulatory capital;
- asset and liability values;
- level of impaired assets and write-offs;
- accounting profit and loss; and
- liquidity and funding gaps.

Stress testing programs should apply across the credit union businesses and cover a range of scenarios, including contagion, historical and non-historical scenarios of the credit union and the external environment.

Stress tests should be developed through open, constructive and creative dialogue. This will improve the likelihood of identifying possible hidden vulnerabilities and avoid underestimating the likelihood and severity of extreme events and having a false sense of security about a credit union's resilience.

Credit unions should assess the impact that severe shocks and periods of sustained economic downturns have on security values and their potential impact on the credit union, including its ability to react to adverse events in a reasonable period of time.

Stress tests should also be used to identify, monitor and control risk concentrations. The scenarios should cover key areas of the credit union, including both on and off-balance sheet assets and contingent and non-contingent risks. Actions beyond contractual obligations that might be undertaken to preserve reputation should also be considered.

Stress tests should feature a range of severities, including events capable of generating the most damage, whether through the size of loss or through loss of reputation. A stress testing program should also determine what scenarios could challenge the viability of the credit union (reverse stress tests). Such tests may be useful in uncovering hidden risks and interactions among risks.

Stress tests should be geared towards events and business areas that might be particularly damaging for the credit union. Areas which benefit in particular from the use of stress testing are financial products and investment opportunities that indicate

exceptionally good risk/return trade-off and new financial products and markets which have not experienced severe strains.

Credit unions should also conduct reverse stress tests. A reverse stress test starts with a specified outcome that challenges the viability of the credit union. An example would be where, over a short time period, the credit union incurs a very large loss that challenges its viability.

The analysis would then work backward (reverse engineered) to identify a scenario or combination of scenarios that could bring about such a specified outcome. The reverse stress test induces credit unions to consider scenarios beyond normal business settings that would include events with contagion and systemic implications.

Credit unions should consider the impact of a reduction in market liquidity on asset valuation and the important interrelations between various factors, including but not limited to:

- price shocks for specific asset categories and run down of corresponding asset liquidity;
- the possibility of significant losses damaging the credit union's financial strength;
- growth of liquidity needs due to liquidity commitments;
- diminished access to secured or unsecured funding markets; and
- securitization risks.

Specific Areas of Focus

The following risks have proven to require specific attention as a result of financial market turmoil. As such, stress testing should be used where the following specific risks are material:

- Risk Mitigation
- Securitization and Warehousing Risks
- Reputation Risks
- Counterparty Credit Risk
- Risk Concentrations

Risk Mitigation

Stress testing should facilitate the development of risk mitigation or contingency plans across a range of stressed conditions. Risk mitigating techniques, like hedging, netting and the use of collateral, should be challenged and assessed systematically under stressed conditions, when markets may not be fully functioning and multiple institutions simultaneously could be pursuing similar risk mitigating strategies. Stress testing should also reflect constraints on management action and should not place undue reliance on the timeliness of mitigating actions.

Securitization and Warehousing Risks

The stress testing program should explicitly cover complex and customized products such as securitized exposures. Stress tests for securitized assets should consider the underlying assets, their exposure to systemic market factors, relevant contractual arrangements and embedded triggers, and the impact of leverage, particularly as it relates to the subordination level in the issue structure.

The stress testing program should also cover pipeline and warehousing risks. These are market, credit and funding risks arising in the period prior to securitization or sale, which may arise from the need to hold assets for longer periods than originally planned when markets are disrupted. A credit union should include such exposures in its stress tests regardless of their probability of being securitized. Many of the risks associated with pipeline and warehoused exposures emerge when a credit union is unable to access the securitization or other markets due to either credit union specific or market stresses.

Reputation Risks

To maintain confidence of members and the general public, credit unions should have an approach to assess the impact of its reputational risks. Credit unions should carefully assess the risks associated with commitments to off-balance sheet vehicles and the possibility that assets will need to be taken on balance sheet for reputational reasons. Therefore, in its stress testing program, a credit union should include scenarios assessing the size and soundness of such vehicles relative to its own financial, liquidity and regulatory capital positions. This analysis should include structural, solvency, liquidity and other risk issues.

Counterparty Credit risk

A credit union may have significant exposures to leveraged counterparties that may be particularly exposed to specific asset types and market movements. Under normal conditions, these exposures are typically completely secured, resulting in zero or very small net exposures. In the case of severe market shocks, however, these exposures may increase abruptly. A credit union should ensure that its stress testing approaches related to derivative counterparties are robust in their capture of related risks.

Risk Concentrations

Stress testing should consider risk concentrations, which include exposures to:

- a single counterparty, borrower or group of connected counterparties;
- industry or economic sectors concentrations;
- geographic regions; and
- similar collateral types.

Stress testing should also consider risk concentrations resulting indirectly from actions to mitigate risks, such as holding derivatives to manage interest rate risk.

Minimum Liquidity Stress Testing Requirements

In order to apply proportionality in minimum liquidity stress testing requirements, the liquidity metric reporting requirements for credit unions with greater than \$500 million in total assets are different from those for credit unions with assets equal to or less than \$500 million.

Satisfying the minimum liquidity metrics do not necessarily mean that a credit union is holding adequate and prudent liquidity. Each credit union will have to determine what they consider to be adequate, and appropriate forms of, liquidity based on their individual business and risk profile and demonstrate that such determination is prudent.

The minimum ratios outlined throughout this guidance represent pre-stress minimum requirements and FSRA has the discretion to exercise forbearance during stress to allow credit unions to operate at a lower level.

The following sections outline the specific liquidity metrics for credit unions with total assets above \$500 million and for credit unions with assets equal to or less than \$500 million.

Credit Unions with Assets Greater than \$500 Million

FSRA expects larger, more complex credit unions to develop comprehensive liquidity testing programs that consider multiple scenarios of varying degrees of stress and time horizons. FSRA's assessment of an effective stress testing program will focus on the credit union's design of exceptional but plausible scenarios that capture elements of the following, where relevant to the credit union:

- Credit union specific events (for example, events leading to loss of wholesale funding access, inability to draw on commitments from other entities)
- Market-wide disruptions
- Combination of both

Stress Testing Metrics

The LCR, NSFR and NCCF are metrics introduced by Basel Committee on Banking Supervision ("BCBS") and adopted by regulatory bodies in Canada including the Office of Supervision of Financial Institutions ("OSFI") and provincial credit union regulators help measure, monitor and manage the level of liquidity at a credit union beyond the simple liquidity ratio under minimum stress assumptions. Credit unions with assets in excess of \$500 million are required to complete an updated LCR, NSFR and NCCF template on a monthly basis effective January, 2018.

1. Liquidity Coverage Ratio (LCR)

The LCR aims to ensure that the credit union has an adequate stock of unencumbered high-quality liquid assets (HQLA) that consists of cash or assets that can be converted into cash at little or no loss in value to meet potential liquidity needs for a 30 calendar day liquidity stress scenario.

FSRA expects that, at a minimum, the LCR should be no lower than 100% on an on-going basis such that the stock of unencumbered HQLA should enable the credit union to survive to Day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions will be taken by management and/or the supervisor, or that the credit union can be resolved in an orderly fashion.

2. Net Stable Funding Ratio (NSFR)

The NSFR helps the credit union maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. FSRA expects that, at a

minimum, the NSFR should be at least 100% on an on-going basis such that the amount of available stable funding is sufficient to cover required stable funding needs. A sustainable funding structure is intended to reduce the likelihood that disruptions to a credit union's regular sources of funding will erode its liquidity position in a way that would increase the risk of its failure and potentially lead to broader systemic stress. The NSFR aims to limit over-reliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance sheet items, and promotes funding stability. In addition, the NSFR approach offsets incentives for credit unions to fund their stock of liquid assets with short-term funds that mature just outside the LCR's 30 day horizon.

3. Net Cumulative Cash Flow (NCCF)

The NCCF measures a credit union's cash flows beyond the 30 day horizon in order to capture the risk posed by funding mismatches between assets and liabilities. The metric helps identify gaps between contractual inflows and outflows over a 12 month time horizon and highlights potential liquidity shortfalls a credit union may need to address. The NCCF identifies a horizon for net positive cash flows in order to capture the risk posed by funding mismatches between assets and liabilities. By utilizing this type of cash flow analysis, credit unions may be able to better mitigate the risk of disruption to market confidence and maintain the ability to meet short-term liabilities in a liquidity crisis. The NCCF analysis offers further perspective into the maturity profile of the credit union's liquidity adequacy. The credit union should set a threshold for the minimum time frame that the NCCF value remains a positive value.

Completion Guides and Templates for computing the LCR, NSFR and NCCF are available on FSRA's website.

Credit unions should also consider using these metrics, appropriately modified, when conducting additional liquidity testing scenarios. At a minimum, credit unions should develop one additional stress scenario under each of these metrics using more conservative assumptions than those outlined with particular emphasis on their individual material balance sheet categories and exposures.

These assumptions should include:

- Limits in the availability/timing of liquidity reserves with Centrals / Leagues

- Reduced availability of wholesale secured and unsecured funding, including asset sales and securitization vehicles
- Higher run-off rates on less stable retail deposits with particular emphasis on concentrated sources of funding, large deposits, brokered deposits and non-standard deposits (e.g. internet deposits).

In addition, credit unions are expected to create at least one scenario that results in a liquidity position that requires the activation of their contingency funding plan.

Reporting

Credit unions with assets greater than \$500 million are required to submit to FSRA an updated LCR template 10 days after the end of each month, beginning on June 1, 2021, with the first monthly report to be provided to FSRA by July 10, 2021. Prior to June 1, 2021, credit unions with assets greater than \$500 million are required to submit to FSRA an updated LCR template at the end of each calendar quarter.

FSRA expects that all CUs operationalize monthly LCR reporting as soon as practical.

Additionally, credit unions with assets greater than \$500 million are required to submit to FSRA an updated NSFR and NCCF template at the end of each calendar quarter. Credit unions should be prepared to submit the NSFR and NCCF templates monthly when requested.

Reporting templates in Excel format are available on FSRA's website.

Credit Unions with Assets Equal to or Less Than \$500 Million

Credit unions should develop liquidity regimes which take into account their size, complexity and risk. FSRA recognizes that the complexity of liquidity regimes will differ and proportional to the size, specific risks and business exposures of the credit union.

Stress Testing Metrics

To ensure that credit unions with assets equal to or less than \$500 million have a prudent tool to measure their ability to withstand a liquidity shock, they should complete an updated LCR template on a monthly basis, effective June 1, 2021.

Additionally, credit unions with assets equal to or less than \$500 million should maintain sufficient liquidity over a longer period to manage both “business as usual” and liquidity stress events.

1. Liquidity Coverage Ratio (LCR)

The LCR aims to ensure that a credit union has an adequate stock of unencumbered HQLA that consists of cash or assets that can be converted into cash at little or no loss in value to meet potential liquidity needs for a 30-calendar day liquidity stress scenario.

FSRA expects that, at a minimum, the LCR should be no lower than 100% on an on-going basis such that the stock of unencumbered HQLA should enable the credit union to survive to Day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions will be taken by management and/or the supervisor, or that the credit union can be resolved in an orderly fashion.

2. Long-Term Liquidity Reporting

Credit unions with assets equal to or less than \$500 million should maintain adequate and prudent liquidity to manage their liquidity needs beyond the 30 days outlined in the LCR. Each credit union is expected to determine what they considered adequate and prudent long-term liquidity based on their specific business exposures and risk appetite, which should be outlined in their liquidity policies.

Credit union management should be able to demonstrate to their boards that they have adequate liquidity to manage their long-term liquidity needs under “business as usual” and stress scenarios. As part of its regular supervisory process, FSRA will request evidence that credit unions have adequately liquidity to manage both short-term and long-term liquidity needs.

Reporting

Credit unions with assets equal to or less than \$500 million are required to submit to FSRA an updated LCR template 10 days after the end of each month, beginning on June 1, 2021, with the first monthly report to be provided to FSRA by July 10, 2021.

Reporting templates in Excel format are available on FSRA’s website.

FSRA's Assessment Process

As part of its on-going review process, FSRA undertakes an assessment of the inherent risks within each significant activity undertaken by a credit union and evaluates the quality of risk management applied to mitigate these risks.

FSRA expects to see evidence that stress testing has been integrated into the credit union's risk management, business planning and capital and liquidity management processes.

In assessing the credit union's stress testing program, FSRA will:

- review and evaluate the extent of the program and the nature of Board oversight;
- evaluate whether the scenarios used are consistent with the credit union's risk appetite;
- assess whether the frequency and timing of stress testing is sufficient to support timely Senior Management action;
- assess whether the stress testing program and selected scenarios are appropriate for the structure, size, complexity and risk profile of the credit union;
- evaluate the scope and severity of stress testing;
- evaluate how stress testing analysis is integrated into the credit union's decision making process;
- evaluate board reports and the extent of Board deliberations on findings and recommendations;
- evaluate the effectiveness of the program in identifying material vulnerabilities; and
- review Senior Management (and/or Board) actions in response to stress testing results.

This assessment will also form part of FSRA's examination criteria when considering the quality of capital management policies and practices when reviewing the credit union's Internal Capital Adequacy Assessment Process (ICAAP).

Effective Date and Future Review

This decision became effective on January 1, 2021 and will be reviewed no later than January 1, 2024.

About this Guidance

This Guidance is an Approach. Approach Guidance describes FSRA's internal principles, processes and practices for supervisory action and application of Chief Executive Officer discretion. Approach Guidance may refer to compliance obligations but does not in and of itself create a compliance obligation. Visit [FSRA's Guidance Framework](#) to learn more.

Appendices and Reference

Appendix 1: Stress Testing Techniques

Scenario Testing

Scenario testing uses a hypothetical future state of the world to define changes in risk factors affecting a credit union's operations. This will normally involve changes in a number of risk factors, as well as ripple effects and other impacts that follow logically from these changes and related management and regulatory actions. Scenario testing is typically conducted over the time horizon appropriate for the business and risks being tested.

Sensitivity Testing

Sensitivity testing typically involves an incremental change in a risk factor (or a limited number of risk factors). It is typically conducted over a shorter time horizon, for example an instantaneous shock.

Sensitivity testing requires fewer resources than scenario testing and can be used as a simpler technique for assessing the impact of a change in risks when a quick response or when more frequent results are needed.

Reverse Stress Testing

Reverse stress tests start with a known stress outcome and then ask what event or series of events could lead to such outcome.

Appendix IV – Proposed Completion Guide: Amended Liquidity Coverage Ratio

Guidance

Interpretation

Approach

Information

Decision



Effective Date: January 1, 2021

Identifier: No. CU0066APP

Liquidity Coverage Ratio Completion Guide

Purpose

The Liquidity Coverage Ratio (LCR) is a measure that aims to ensure that a credit union has an adequate stock of unencumbered high-quality liquid assets (HQLA) that can be converted into cash at little or no loss of value, to meet its liquidity needs for a 30 calendar day liquidity stress scenario. This Approach Guidance provides credit unions with a guide to be used with the calculation and the reporting of the LCR.

Scope

This Approach guidance affects the following entities regulated by FSRA:

- Credit Unions and Caisses Populaires incorporated under the *Credit Union and Caisses Populaires Act, 1994* (the Act)

This Guidance complements the information provided in, and should be read in conjunction with, other FSRA guidance and supporting publications available on FSRA's website (www.fsrao.ca).

Approach

Processes and Practices

Introduction

1. The LCR is a measure that aims to ensure that a credit union has an adequate stock of unencumbered HQLA that can be converted into cash at little or no loss of value, to meet its liquidity needs for a 30 calendar day liquidity stress scenario. At a minimum, the stock of unencumbered HQLA should enable the institution to survive until day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions can be taken by management and supervisors. Also, given the uncertain timing of outflows and inflows, institutions are expected to be aware of any potential mismatches within the 30-day period and ensure that sufficient HQLA are available to meet any cash flow gaps throughout the period.

Assumptions

2. These assumptions are based on a stressed liquidity scenario that encompasses a combination of idiosyncratic and systemic stresses which measure the impacts of assumptions over a 30-day liquidity horizon. Stress assumptions include:
 - cash flows from eligible unencumbered liquid assets;
 - partial run-off of retail deposits;
 - partial loss of unsecured wholesale funding and secured financing capacity; and
 - unscheduled draws on committed but unused credit facilities.

Minimum requirements

3. This stress test should be viewed as a minimum requirement. Credit unions are expected to conduct their own stress tests to assess the level of liquidity they should hold beyond this minimum, and construct their own scenarios that could cause difficulties for their specific business activities. Such internal stress tests should incorporate longer time horizons than 30 days.

4. The LCR has two components:
 - a. Value of the stock of HQLA in stressed conditions; and
 - b. Total net cash outflows, calculated according to the scenario parameters outlined below.

Net cash outflows is defined as the total expected cash outflows minus total expected cash inflows in the specified stress scenario for the subsequent 30 calendar days.

5. The value of the ratio should be no lower than 100% (i.e. the stock of HQLA should at least equal total net cash outflows) on an ongoing basis as the stock of unencumbered HQLA is intended to serve as a defense against the potential onset of liquidity stress.

HQLA

6. All assets in the stock of HQLA should be unencumbered. “Unencumbered” means free of legal, regulatory, contractual or other restrictions on the ability of the credit union to liquidate, sell, transfer, or assign the asset. An asset in the stock should not be pledged (either explicitly or implicitly) to secure, collateralise or credit-enhance any transaction, nor be designated to cover operational costs (such as rents and salaries). Assets received in reverse repo and securities financing transactions that are held at the institution, have not been rehypothecated, and are legally and contractually available for the institution’s use can be considered as part of the stock of HQLA.
7. Credit unions should ensure that their HQLA held and/or managed by a third-party who is acting as liquidity manager be available on demand, unencumbered, and held in a structure that is bankruptcy remote and creditor proof. For greater clarity, this means that the credit union’s assets held for liquidity purposes and managed by a third-party must not be subject to the claims of the creditors of that third-party, including in the circumstances of its potential insolvency, bankruptcy or winding-up.
8. A credit union’s management and board should ensure that the credit union has timely and unfettered access to its HQLA before leadership includes them in their LCR calculation.

9. There are two categories of assets that can be included in the stock of HQLA. Assets to be included in each category are those that the credit union is holding on the first day of the stress period, irrespective of their residual maturity.

Level 1 Assets

10. "Level 1" assets can be included without limit and include:

- Cash on hand currently held by the credit union;
- Securities issued under the NHA MBS (including holdings of NHA MBS, and CMBs and unencumbered qualifying replacement assets where (a) there is sufficient guarantee allocation room to allow for the re-designation of replacement NHA MBS as NHA MBS for sale to the market OR the guarantee fee has been paid at issuance, AND (b) the credit union has the ability to monetise the NHA MBS in a timely manner; and
- Qualifying marketable securities representing claims on or guaranteed by sovereigns, central banks, PSEs or multilateral development banks assigned a 0% risk-weight under the Basel II including any debt instrument that can be readily converted into cash through repo or cash markets.

Level 2 Assets

11. Level 2 assets are limited to a 40% cap of total HQLA after applicable haircuts.

Level 2A Assets

12. A 15% haircut is applied to the current market value of each Level 2A asset which includes:

- Qualifying marketable securities representing claims on or guaranteed by sovereigns, central banks, PSEs or multilateral development banks assigned a 20% risk-weight under the Basel II; and
- Qualifying corporate debt securities (including commercial paper) and covered bonds that have a long-term credit rating from a recognised external credit assessment institution (ECAI) of at least AA-.

Level 2B Assets

13. Level 2B assets are also limited to a 15% cap of total HQLA after applicable haircuts.

14. Level 2 B assets include:

- 25% haircut - Residential mortgage backed securities (RMBS);
- 50% haircut - Qualifying corporate debt securities (including commercial paper) and covered bonds that have a long-term credit rating from a recognised external credit assessment institution (ECAI) between A+ and BBB-; and
- 50% haircut - Qualifying corporate (non-financial) common equity shares.

Cash outflows

15. Total expected cash outflows are calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down. Where amounts cannot be readily determined for any specific category, credit unions must report amounts using the more conservative (higher run offs) category under each funding source. Credit unions may report monthly amounts by applying percentage factors based on the most up to date financial year end balances for each category as applicable.

Retail Deposits (Personal and Small Business)

16. “Small business customers” are defined in line with the definition of loans extended to small businesses in paragraph 231 of the Basel II framework that are managed as retail exposures and are generally considered as having similar liquidity risk characteristics to retail accounts provided the total aggregated funding raised from one small business customer is less than CAD \$1.5 million (on a consolidated basis where applicable).

Stable Deposits

17. Term Deposits with a residual maturity greater than 30 days – 0% run off

Total retail, insured and uninsured, term deposits with a residual maturity or withdrawal notice period greater than 30 days where the depositor has no legal right to withdraw deposits within 30 days, or where early withdrawal results in a significant penalty that is materially greater than the loss of interest. If the Credit Union allows depositors to withdraw such deposits without applying the corresponding penalty, or despite a clause stating the depositor has no legal right

to withdraw, the entire category of these funds would have to be treated as demand deposits.

18. Insured deposits with established relationship or in transactional accounts – 3% run off

Examples of established relationships include members that also have a loan, line of credit or investments with the credit union. Examples of transactional accounts include accounts where there are automatic regular deposits of salary, pensions or other sources of income. Where a credit union is not readily able to identify which retail deposits would qualify as stable deposits under paragraph 16, it should report the full amount under paragraph 17. Where a credit union is not readily able to identify which retail deposits would qualify as insured deposits under paragraph 17 it should report the full amount under paragraph 18 as appropriate.

19. Other insured deposits – 5% run off

This includes other insured deposits that are not included in any other category.

Less Stable Deposits

20. Less stable deposits – 10% run off

These deposits include; Uninsured demand and term deposits, brokered deposits, large deposits, foreign currency deposits and other deposits (e.g. trust accounts, internet accounts etc.) not already identified. Brokered deposits are deposits sourced from unaffiliated third-parties or acquired through deposit agents.

Unsecured Wholesale Funding

21. For the purposes of the LCR, "unsecured wholesale funding" is defined as those liabilities and general obligations that are raised from non-natural persons (i.e. legal entities, including sole proprietorships and partnerships) and are **not** collateralised by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution. Obligations related to derivative contracts are explicitly excluded from this definition.

22. The wholesale funding included in the LCR is defined as all funding that is callable within the LCR's horizon of 30 days or that has its earliest possible contractual

maturity date situated within this horizon (such as maturing term deposits and unsecured debt securities) as well as funding with an undetermined maturity. This should include all funding with options that are exercisable at the investor's discretion within the 30-calendar day horizon.

Operational Deposits

- 23.** Certain activities lead to financial and non-financial customers needing to place, or leave, deposits with a credit union in order to facilitate their access and ability to use payment and settlement systems and otherwise make payments.
- 24.** Qualifying activities in this context refer to clearing, custody or cash management activities where (a) the customer is reliant on the credit union to perform these services as an independent third-party intermediary in order to fulfill its normal banking activities over the next 30 days, and (b) these services must be provided under a legally binding agreement to institutional customers.
- 25.** Qualifying operational deposits generated by such an activity are ones where (a) the deposits are by-products of the underlying services provided by the credit union and not sought out in the wholesale market in the sole interest of offering interest income, and (b) the deposits are held in specifically designated accounts and priced without giving an economic incentive to the customer (not limited to paying market interest rates) to leave any excess funds on these accounts.

Operational Deposits (Insured)

- 26.** Insured operational deposits – 5% run off

Operational Deposits (Uninsured)

- 27.** Uninsured operational deposits - 25% run off

Non-Operational Deposits

- 28.** This category comprises all deposits and other extensions of unsecured funding from **non-financial** corporate customers and sovereign, central bank, multilateral development bank, and PSE customers that are not specifically held for operational purposes.

Non-Financial Institution - Non-Operational (Insured)

29. Insured non-operational deposits – 20% run off

Non-Financial Institution – Non-Operational (Uninsured)

30. Uninsured non-operational deposits – 40% run off

Other non-operational deposits – 100% run off

31. All other non-operational deposits and other funding from banks, other financial institutions and other legal entities (includes borrowings from Central 1, a league or other financial institution that are not secured by specific assets).

Secured Wholesale Funding

32. This includes liabilities or general obligations that are collateralised by legal rights to specifically designated assets owned by the Credit Union and repo transactions⁹ that mature within 30 days.

33. Secured Funding and repo transactions with a domestic central bank or central credit union or league counterparty or backed by level 1 assets which would otherwise have been reported in the institution's eligible HQLA receive a 0% run off factor. This includes NHA MBS pledged as part of a secured funding transaction and NHA MBS sold under the CMB program, including replacement NHA MBS intended as reinvestment assets for CMB issuances prior to July 1, 2016.

⁹ A repurchase transaction (repo) is an agreement whereby an entity agrees to sell securities at a specified price and then repurchase the securities on a specified date at a specified price in exchange for cash.

34. All other secured funding and repo transactions receive outflows in accordance with the following schedule.

Categories for outstanding maturing secured funding transactions	Cash Outflows
Backed by Level 2A assets	15%
Secured funding transactions with domestic sovereign, PSEs or multilateral development banks that are not backed by Level 1 or 2A assets. PSEs that receive this treatment are limited to those that have a risk weight of 20% or lower.	25%
Backed by RMBS eligible for inclusion in Level 2B	25%
Backed by other Level 2B assets	50%
Other	100%

35. All other secured funding transactions include borrowings from Central 1, a league or other financial institution that are secured by specific assets.

Other Outflows

36. Derivatives – 5% run off

All derivative-related cash outflows should be included at the expected contractual payment dates in accordance with their existing valuation methodologies. Cash flows may be calculated on a net basis (i.e., inflows can offset outflows) by counterparty, only where a valid master netting agreement exists. Options should be assumed to be exercised when they are ‘in the money’ to the option buyer. Credit unions should not double count liquidity inflows or outflows.

Where derivative payments are collateralized by eligible liquid assets, outflows should be calculated net of any corresponding inflows that would result from contractual obligations for collateral to be provided to the credit union; this is

conditioned on the credit union being legally entitled and operationally capable to re-use the collateral in new cash raising transactions once the collateral is received.

37. Guarantees and Letters of Credit – 5% run-off

Trade finance instruments consist of trade-related obligations directly underpinned by the movement of goods or the provision of services. Amounts to be reported include items such as outstanding documentary trade letters of credit, documentary and clean collection, import bills, and export bills; and outstanding guarantees directly related to trade finance obligations, such as shipping guarantees. Lending commitments, such as direct import or export financing for non-financial corporate firms, should not be reported here, and rather reported as committed facilities.

38. Committed Lines of Credit: Retail and Small Business (Undrawn) – 5% run off

Report balances of undrawn committed credit and liquidity facilities extended by the Credit Union to natural persons (retail) and small business customers.

39. Committed Lines of Credit: Commercial/Corporate (Undrawn) – 10% run off

Balances of undrawn committed credit facilities extended by the Credit Union to non-financial institutions corporations (excluding small business customers). The amount reported should also include any 'additional capacity' of liquidity facilities provided to non-financial corporates.

40. Uncommitted Lines of Credit: Retail and Small Business (Undrawn) – 2% run off

Balances of undrawn credit and liquidity facilities provided to retail and small business customers where the Credit Union has the right to unconditionally revoke the undrawn portion of these facilities.

41. Uncommitted Lines of Credit: Commercial/Corporate (Undrawn) – 5% run off

Balances of undrawn credit and liquidity facilities provided to other customers where the Credit Union has the right to unconditionally revoke the undrawn portion of these facilities.

Cash inflows

42. Total expected cash inflows are calculated by multiplying the outstanding balances of various categories of contractual receivables by the rates at which they are expected to flow in under the scenario up to an aggregate cap of 75% of total expected cash outflows.

Maturing Reverse Repurchase or Securities Borrowing Transactions

43. Due to the high-quality of Level 1 assets, credit unions should assume that maturing reverse repurchase or securities borrowing agreements secured by Level 1 assets will be rolled-over and will not give rise to any cash inflows. (0%) Credit unions are assumed **not** to roll-over maturing reverse repurchase or securities borrowing agreements secured by non-HQLA assets, and can assume to receive cash inflows of 100% related to those agreements.

44. Cash inflows will be assigned to all other maturing transactions secured by Level 2 assets in accordance with the following schedule.

Categories for outstanding maturing secured funding transactions	Cash Inflow ¹⁰
Backed by Level 2A assets	15%
Secured funding transactions with domestic sovereign, PSEs or multilateral development banks that are not backed by Level 1 or 2A assets. PSEs that receive this treatment are limited to those that have a risk weight of 20% or lower.	25%
Backed by RMBS eligible for inclusion in Level 2B	25%

¹⁰ EXCEPTION: Where securities are rehypothecated, the credit union must assume a 0% cash inflow.



Backed by other Level 2B assets

50%

Loans

45. Credit unions should only include inflows from fully performing loans. Non-performing loans are those that are greater than 90 days delinquent. Further, inflows should only be taken at the latest possible date, based on the contractual rights available to counterparties.

46. Inflows from loans that have no specific maturity should not be included; therefore, no assumptions should be applied as to when maturity of such loans would occur. An exception to this would be minimum payments of principal, fee or interest associated with an open maturity loan, provided that such payments are contractually due within 30 days.

Retail, Small Businesses and Non-Financial Corporate

47. Credit unions are assumed to receive all payments (including interest payments and instalments) from retail, small business and non-financial corporate members that are fully performing and contractually due within a 30-day horizon.

Only **contractual payments** due should be reported (e.g. required minimum payments of principal, fee or interest) and not total loan balances of undefined or open maturity. At the same time, however, credit unions are assumed to continue to extend loans at a rate of 50% of contractual inflows. This results in a net inflow rate of 50% of the contractual amount.

Financial Institutions

48. Credit unions are assumed to receive all payments (including interest payments and installments) from financial institutions that are fully performing and contractually due within the 30-day horizon and are assumed to discontinue to extend loans. This results in an inflow rate of 100% of the contractual amount.

5.3 Maturing Securities

- 49.** Contractual inflows from securities, including certificates of deposit, maturing ≤ 30 days that are not already included in any other classification code, provided that they are fully performing (no default expected). Inflows from securities maturing within 30 days not included in the stock of HQLA 1 should receive 100% inflow.
- 50.** Level 1 and Level 2 securities maturing within 30 days should be included in the stock of HQLA, provided that they meet all related operational and definitional requirements.

Deposits at Other Financial Institutions

- 51.** Deposits held at other financial institutions for operational purposes are assumed to stay at those institutions, and no inflows can be counted for these funds. All other deposits that are or become available within the 30 days LCR time horizon receive 100% inflow. Includes deposits held at Central 1 or a League.

Derivatives

- 52.** All derivative-related cash outflows should be included at the expected contractual payment dates in accordance with their existing valuation methodologies. Cash flows may be calculated on a net basis (i.e., inflows can offset outflows) by counterparty, only where a valid master netting agreement exists. Options should be assumed to be exercised when they are 'in the money' to the option buyer. Credit unions should not double count liquidity inflows or outflows. Where derivative payments are collateralized by eligible liquid assets, outflows should be calculated net of any corresponding inflows that would result from contractual obligations for collateral to be provided to the credit union; this is conditioned on the credit union being legally entitled and operationally capable to re-use the collateral in new cash raising transactions once the collateral is received. The sum of all net cash inflows should receive a 100% inflow.

Committed LOC with Central 1, League or Other Financial Institution

- 53.** Committed LOC with Central Credit union, League or other financial institution that is available within 30 days receive a 100% inflow.

Effective Date and Future Review

This Approach Guidance became effective on January 1, 2021 and will be reviewed no later than January 1, 2024.

About this Guidance

This Guidance is an Approach. Approach Guidance describes FSRA's internal principles, processes and practices for supervisory action and application of Chief Executive Officer discretion. Approach Guidance may refer to compliance obligations but does not in and of itself create a compliance obligation. Visit [FSRA's Guidance Framework](#) to learn more.

Appendices and Reference

Appendix 1: Summary Haircuts and Cash Flow Rates

Reference	Balance Sheet Items	Haircut/Cash Flow
HQLA		
Level 1	Cash on Hand NHA MBS Qualifying marketable securities (0% RW)	0%
Level 2A	Qualifying marketable securities (0% RW) Qualifying corporate debt AA- or higher	15%
Level 2B	Qualifying RMBS Qualifying corporate debt A+ to BBB- Corporate Common equity shares	25% 50% 50%
Liabilities		Cash outflows
Retail Deposits (Personal, and Small Business)		
Stable Deposits	Term Deposits with residual maturity >30 days	0%
Term & other deposits with residual maturity/callable within 30 days		
	Insured deposits with established relationships or in transactional accounts	3%
	Other Insured deposits	5%
Less Stable Deposits	Uninsured deposits Brokered deposits Large deposits Other deposits (e.g. trust accounts, internet)	10%
Unsecured Wholesale Funding		
Term & other deposits with residual maturity/callable within 30 days		
Operational Deposits	Insured	5%
	Uninsured	25%

Non-Operational Deposits	Insured	20%
	Uninsured	40%
		100%
	Non-operational deposits and other funding from banks, other financial institutions and other legal entities (includes borrowings from Central 1, a league or other financial institution that are not secured by specific assets)	
Secured Funding		
Term & other deposits with residual maturity/callable within 30 days		
Secured Funding	Transactions with a central bank counterparty or backed by Level 1 assets with any counterparty	0%
	Transactions backed by Level 2A assets	15%
	Transactions backed by non-Level 1 or non-Level 2A assets, with domestic sovereigns, development banks, or domestic PSEs as a counterparty	25%
	Backed by Residential Mortgage Backed Securities (Level 2B eligible)	25%
	Backed by other Level 2B assets	50%
	All other transactions (includes borrowings from Central 1, a league or other financial institution that are secured by specific assets)	100%
Other		
	Derivatives	5%
	Guarantees and Letters of Credit	5%
	Committed Lines of Credit - Retail and Small	5%

	Business (Undrawn)	
	Committed Lines of Credit – Commercial/Corporate (Undrawn)	10%
	Uncommitted Lines of Credit - Retail and Small Business (Undrawn)	2%
	Uncommitted Lines of Credit – Commercial/Corporate (Undrawn)	5%
Assets		Cash inflows
Maturing reverse repurchase or securities borrowing agreements		
	Secured by level 1 assets	0%
	Secured by level 2A assets	15%
	Secured by non-Level 1 or non-Level 2A assets, with domestic sovereigns, development banks, or domestic PSEs as a counterparty	25%
	Secured by Residential Mortgage Backed Securities (Level 2B eligible)	25%
	Secured by other Level 2B assets	50%
Loans	Payments on loans to retail, small business and non-financial corporate	50%
	Payments on loans to financial institutions	0%
Other	Maturing Securities	100%
	Deposits at other financial institutions - maturing or callable within 30 days (Includes deposits at Central 1 or a League)	100%
	Derivatives	100%
	Committed LOC with Central 1, League or other FI	100%

Appendix V – Proposed Completion Guide: Proposed Net Cumulative Cash Flow

Guidance

Interpretation

Approach

Information

Decision



Effective Date: January 1, 2021

Identifier: No. CU0067APP

Net Cumulative Cash Flow Completion Guide

Purpose

The Net Cumulative Cash Flow (NCCF) is a liquidity metric that measures a credit union's survival horizon based on its net cumulative cash flows. This Approach Guidance provides credit unions with a guide to be used with the calculation and the reporting of the NCCF.

Scope

This Approach Guidance affects the following entities regulated by FSRA:

- Credit Unions and Caisses Populaires incorporated under the *Credit Union and Caisses Populaires Act, 1994* (the Act)

This Guidance complements the information provided in, and should be read in conjunction with, other FRSA guidance and supporting publications available on FSRA's website (www.fsrao.ca).

Approach

Processes and Practices

Introduction

1. The NCCF is a liquidity metric that measures a credit union's survival horizon based on its net cumulative cash flows. It identifies potential future funding mismatches between contractual inflows and outflows for various time bands over and up to a 12-month time horizon. It measures a credit union's detailed cash flows, in order to capture the risk posed by funding mismatches between assets and liabilities, after the application of assumptions around the functioning of assets and modified liabilities. NCCF definitions mirror those outlined in the Liquidity Coverage Ratio (LCR), unless otherwise specified. All references to LCR definitions in the NCCF refer to the definitions outlined in the LCR documents.

Assumptions

2. These assumptions are based on a stressed liquidity scenario that encompasses a combination of idiosyncratic and systemic stresses which measure the impacts of assumptions over a one-year liquidity horizon. Stress assumptions include:
 - cash flows from eligible unencumbered liquid assets;
 - partial run-off of retail deposits; and
 - partial run-off of wholesale or brokered deposits.
3. The time buckets reported under the NCCF include monthly buckets for month 1 to month 12, and a greater than 12 month's bucket. Cash flows associated with assets and liabilities that have a contractual maturity should be considered based on their residual contractual maturity, unless otherwise specified.

Inflows

4. Cash inflow treatments for balance sheet assets are determined by whether the asset meets the criteria for an unencumbered liquid asset and its residual contractual maturity date or earliest option date unless instructed otherwise.

Eligible Unencumbered Liquid Assets (EULA)

5. Cash inflows of unencumbered liquid assets reported in the month 1 time bucket after the appropriate haircut is applied to in accordance with the EULA Haircuts Table (refer Appendix 1). Securities that are not qualified as EULA receive a 100% haircut. The haircut amount of maturity inflows are to be reported in the contractual maturity time bucket of the NCCF report.
6. Unencumbered means free of legal, regulatory, contractual or other restrictions on the ability of the credit union to liquidate, sell, transfer, or assign the asset. The asset should not be pledged, either explicitly or implicitly, to secure, collateralize or credit-enhance any transaction, nor be designated to cover operational costs such as rents and salaries. The asset should also be accessible by the function charged with managing the liquidity of the credit union (e.g. the treasurer).
7. Report all unencumbered *National Housing Act* Mortgage-backed Securities (NHA MBS) balances in this section, regardless of its pool size. These include MBS purchased as investments and MBS created and which qualify for sale (e.g. market MBS).
8. Credit unions should only include liquid assets that can be monetized through operational capability; the credit union should have procedures and appropriate systems in place, including providing the liquidity management function with access to all necessary information, to execute monetization of any asset at any time.

Other Unencumbered Liquid Assets

9. Assets received in reverse repurchase agreements and securities financing transactions that are held at the credit union, have not been re-hypothecated, and are legally and contractually available for the credit union's use can be considered as part of the pool of liquid assets and included in month 1.
10. Credit unions may receive liquidity value for collateral swaps provided they can clearly demonstrate that, at a minimum, the transactions are for a specified contract period, the securities used for the underlying collateral being swapped are outlined in the transaction details, mark-to-market procedures are understood and documented, and there is not substitution of collateral over the life of the contract, unless it is a like-for-like substitution. In addition, credit unions should have adequate

and ongoing market risk management control and oversight of collateral swap activity, and recognize liquidity or cash flow implications at the termination of the swap.

Cash inflows from reverse repurchase agreements which do not meet the conditions outlined above are assumed to occur at contractual maturity.

Deposits with Centrals, Leagues or Other Financial Institutions

11. Demand deposits with centrals, leagues or other financial institutions are to be treated as cash inflows in month 1. Term deposits are treated as cash inflows in the earliest contractual maturity time bucket.

Other Securities

12. Cash inflows from other government securities, mortgage-backed securities, asset-backed securities, corporate commercial paper, and corporate bonds, which are not considered eligible unencumbered liquid assets, should be reported in the contractual maturity time buckets.

For securities eligible as unencumbered liquid assets, balances are treated as cash inflows in month 1 after the appropriate haircut. Cash inflows are limited to the face value of the security.

13. Cash inflows from securities borrowed are assumed to occur at contractual maturity for the principal amount borrowed. Interest will not be recognized as a cash inflow.

Other Investments

14. Other investments, which are not considered eligible unencumbered liquid assets, are to be reported in greater than 12-month time bucket with the exception of cash inflows for dividends which are to be reported on the declaration date.

Personal Loan Portfolio

15. Credit unions have the option to report (a) blended loan amortization and interest payment inflows or (b) suppress interest payments and report loan amortization payments only as appropriate. Whichever method is adopted must be consistent with reporting deposit payment outflows (Refer paragraph 33). Non-performing loans are loans that are greater than 90 days delinquent.

Residential Mortgages

- 16.** Credit unions should only include contractual inflows from outstanding exposures that are fully performing. Contingent inflows are not to be included in cash inflows.
- 17.** No cash inflow value would be received for inflows from balances at maturity, as residential mortgages are assumed to roll over at 100%. Payment inflows are assumed to continue at the same level for month 1 to 12.

Securitized Residential Mortgages

- 18.** Balances at maturity and the balance of period amortization payments of residential mortgages securitized and unsold (i.e. the mortgage backed securities) are treated as cash inflows in the first time bucket after the appropriate haircut is applied and reported under HQLA.(refer to paragraph 7) .
- 19.** For residential mortgages securitized and used to back Canada Housing Trust (CHT) swaps, cash inflows from these securitized mortgages, both balance at maturity and periodic amortization payments, are to be reported in time buckets corresponding to the CHT swap contractual maturity. For mortgages securitized and encumbered, the corresponding liability is not assumed to roll over.
- 20.** For residential mortgages that are securitized and sold to third-parties, periodic amortization payments and payment of balance at maturity cash inflows are to be reported in each time bucket when the payments are recognized.

Term Loans

- 21.** Credit unions should only include contractual inflows from outstanding term loans that are fully performing. Contingent inflows are not to be included in cash inflows. No rollover at maturity is assumed.

Lines of Credit

- 22.** Cash inflows from lines of credit are assumed to occur at the latest possible time band within the contractual maturity date. Cash inflows from a line of credit which has no specific maturity date should be reported based on cash flows generated from the specified minimum payments.

Leases & Other

23. Credit unions should only include contractual inflows from outstanding leases and personal loan exposures that are fully performing. Contingent inflows are not to be included in cash inflows. No rollover at maturity is assumed.

Commercial Loan Portfolio

24. Refer to Section 3.6 Personal Loan Portfolio for cash flow treatments and assumptions for the commercial loan portfolio.

All Other Assets

25. All other assets not mentioned above are to be reported in the NCCF report, but no cash flow value will be attributed to them. These amounts are to be reported in the greater than 12 months' time bucket.

26. All derivative-related cash inflows should be included at expected contractual payment dates in accordance with their existing valuation methodologies. Cash flows may be calculated on a net basis (i.e., inflows can offset outflows) by counterparty, only where a valid master netting agreement exists. The amount of derivatives cash inflows and outflows should be calculated in accordance with other provisions of the methodology described in section 4.2, paragraph 53, below.

27. Credit unions should not double count liquidity inflows or outflows. Where derivatives are collateralized by eligible liquid assets, inflows should be calculated net of any corresponding outflows that would result from contractual obligations for collateral to be posted by the credit union, given these contractual obligations would reduce the pool of eligible liquid assets.

Outflows

28. The cash outflow treatments for balance sheet liabilities items differ depending on whether the liability has a contractual maturity or no specific maturity date. Balances should be run-off on a declining balance basis.

29. Unless instructed otherwise, cash outflow for balance sheet liabilities with contractual maturities are not assumed to roll over and to be allocated to maturity buckets corresponding with their contractual maturity or earliest option date.

30. Consistent with the underlying intent of the metric, no rollover of existing liabilities is generally assumed to take place, with the exception of retail and small business term deposits. Run-offs for retail and small business term deposits will be assumed to renew at the same term as the original deposit, less the applicable run-off rate.

31. The general treatment described above applies to:

- repurchase agreements;
- term deposits other than retail and small business term deposits, regardless of the counterparty type;
- other wholesale liabilities including commercial paper, certificates of deposit, deposit notes, and bonds; and
- outflows from FI-sponsored ABCP, SIVs, and securitizations.

Deposits

32. Credit unions have the option to report (a) blended deposit repayment and interest payment outflows or (b) suppress reporting of interest payment outflows as appropriate. Whichever method is adopted must be consistent with reporting of loan payment inflows (Refer paragraph 16). Where amounts cannot be readily determined for any specific category, credit unions must report amounts using the more conservative (higher run offs) category under each funding source. Credit unions may report initial monthly amounts by applying percentage factors based on the most up to date financial year end balances for each category as applicable.

Retail Deposits

33. Retail deposits are deposits placed with a credit union by a natural person or small business. Retail deposits are assumed to renew with a portion of the remaining deposit balance to be run off every time a renewal is assumed to take place. Cashable term deposits are treated as demand deposits at the first member option date.

Stable Deposits

Insured deposits with established relationship or in transactional accounts

Examples of established relationships include members that also have a loan, line of credit or investments with the credit union. Examples of transactional accounts include accounts where there are automatic regular deposits of salary, pensions or other sources of income. Refer LCR reporting template Lines 12 and 13. Where a credit

union is not readily able to identify which retail deposits would qualify as stable deposits under paragraph 35 or 36, it should report the full amount under paragraph 37 or 38. Where a credit union is not readily able to identify which retail deposits would qualify as insured deposits under 37 or 38, it should report the full amount under paragraph 39 - 42 as appropriate.

34. Demand deposits are assigned a run-off of at 3% per month for month 1 and 1% per month for month 2-12 on a declining balance basis.

35. Term deposits are assigned a run off at 3% at initial maturity with the net balance rolling over to the same term. A run off of 1% is assigned on subsequent renewals, up to month 12.

Other insured deposits

36. Demand deposits are assigned a run-off of 5% for month 1 and 1% per month for month 2-12 on a declining balance basis.

37. Term deposits are assigned a run off 5% at initial maturity with the net balance rolling over to the same term. A run off of 1% is assigned on subsequent renewals, up to month 12.

Less Stable Deposits

Broker Deposits

38. Demand deposits sourced from unaffiliated third-parties or acquired through deposit agents, are assigned a run-off rate of 10% for month 1 and 5% for month 2-12 on a declining basis.

39. Term deposits sourced from unaffiliated third-parties or acquired through deposit agents, are assigned a run-off rate of 10% at initial maturity with the net balance rolling over to the same term. A runoff of 5% is assigned on subsequent renewals, up to month 12.

Other uninsured deposits

40. Demand deposits are assigned a run-off of 10% for month 1 and 5% per month for month 2-12 on a declining balance basis.

41. Term deposits are assigned a runoff of 10% at initial maturity with the net balance rolling over to the same term. A runoff of 5% is assigned on subsequent renewals, up to month 12.

Wholesale Deposits

Term Deposits with original term >30 days

42. All wholesale term deposits with an original term greater than 30 days are assigned a runoff of 100% at the earliest contractual renewal.

Non-Financial Institution – Operational (Insured)

43. For insured unsecured demand wholesale funding provided by non-small business depositors, where the institution has operational deposits generated by clearing, custody and cash management activities, these deposits are generally assigned a run-off of 3% per month on a declining basis.

Non-Financial Institution – Operational (Uninsured)

44. For uninsured unsecured demand wholesale funding provided by non-small business depositors, where the institution has operational deposits generated by clearing, custody and cash management activities, these deposits are generally assigned a run-off of 10% for month 1 and 5% per month for month 2-12 on a declining basis.

Non-Financial Institution – Non-Operational (Insured)

45. For insured unsecured demand wholesale funding provided by non-small business depositors, where the institution has operational deposits generated by clearing, custody and cash management activities, these deposits are generally assigned a run-off of 12.5% for month 1 and 5% per month for month 2-12 on a declining basis.

Non-Financial Institution – Non-Operational (Uninsured)

46. For uninsured unsecured demand wholesale funding provided by non-small business depositors, that are not specifically held for operational purposes are assigned a run-off of 12.5% for month 1 and 10% per month for month 2-12 on a declining basis.

Financial Institutions

47. All wholesale deposits and other funding from all other counterparties (including financial institutions, securities firms, insurance companies, etc.) that are not specifically held for operational purposes and not included in the above categories run-off are assigned a 100% run off at month 1.

Other Outflows

48. Operating/clearing line account balances at Central 1, League or financial institution are expected to remain within their prescribed limits. Repayment of balances in excess of prescribed limits should be reported as an outflow in month 1.

49. Term loans with Central 1, league or financial institution are for cash management purposes, occasional borrowings, assistance with fixed asset purchase, and/or to assist in asset/liability management. Credit unions are expected to repay term loans or other term borrowings in full at maturity date.

50. Cash outflows for other borrowings, including securitization borrowings, are not assumed to roll over and to be reported in full at contractual maturity date.

51. Securities sold short, securities lent and funding guarantees to subsidiaries and branches should all be assumed to have immediate cash outflows (i.e., first maturity bucket) of principal.

52. All derivative-related cash outflows should be included at the expected contractual payment dates in accordance with their existing valuation methodologies. Cash flows may be calculated on a net basis (i.e., inflows can offset outflows) by counterparty, only where a valid master netting agreement exists. Options should be assumed to be exercised when they are 'in the money' to the option buyer. Credit unions should not double count liquidity inflows or outflows. Where derivative payments are collateralized by eligible liquid assets, outflows should be calculated net of any corresponding inflows that would result from contractual obligations for collateral to be provided to the credit union; this is conditioned on the credit union being legally entitled and operationally capable to re-use the collateral in new cash raising transactions once the collateral is received.

53. Other balance sheet liabilities not mentioned above are to be reported in the NCCF, but no cash outflow value is attributed to them.

Equity

54. Cash outflows for equity are assumed to occur at 100% in the greater than 12 month time bucket.

Memo items - commitments

55. Off-balance sheet funding guarantees are defined as explicit contractual agreements or obligations to extend funds at a future date to retail or wholesale counterparties. For purposes of the NCCF, these facilities only include contractually irrevocable (“committed”) or conditionally revocable agreements to extend funds in the future to third-parties, and will be reported in the NCCF template but will not be included as outflows.

Effective Date and Future Review

This Approach Guidance became effective on January 1, 2021 and will be reviewed no later than January 1, 2021.

About this Guidance

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Appendices and Reference

Appendix 1: Securities Haircuts Table

Securities Haircut Table	
Rating	Equivalent Credit Rating
High Rated	AA- / Aa3 to AAA / Aaa
Medium Rated	A-/A2 to A+ / A1
Low Rated	D to BBB+/Baa1 or not rated

	Haircut
Securities	
High Rated Government Securities	
Sovereign & Central Bank Government Securities	0.5%
State, Provincial & Agency Government Securities	1.5%
State Municipal Government Securities	5.0%
Medium Rated Government Securities	
Sovereign & Central Bank Government Securities	10.0%
State, Provincial & Agency Government Securities	13.0%
State Municipal Government Securities	20.0%
Non-FI Issued Corporate Bonds and Paper (High rated)	
Non-FI issued unsecured bonds and paper (High rated)	5.0%
Non-FI issued covered bonds (High rated)	5.0%

FI Issued Corporate bonds and Paper (High Rated)

FI issued unsecured bonds and paper (High rated)	9.0%
FI issued covered bonds (High rated)	9.0%

Non-FI Issued Corporate Bonds and Papers (Medium Rated)

Non-FI issued unsecured bonds and paper (Medium rated)	10.0%
Non-FI issued covered bonds (Medium rated)	10.0%

FI Issued Corporate Bonds and Paper (Medium rated)

FI issued unsecured bonds and paper (Medium rated)	11.0%
FI issued covered bonds (Medium rated)	11.0%
Non-FI Issued ABCP (High rated) (Note 1)	7.5%

FI Issued ABS and ABCP (High rated)

FI issued ABCP (High rated)	7.5%
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For all other securities **100%**

Loans

Securitized Residential Mortgages

EULA Securitized Res Mort (Balance at Maturity)	4.0%
EULA Securitized Res Mort (Payments)	4.0%

Securitized Commercial Mortgages

EULA Securitized Coml Mort (Balance at Maturity)	4.0%
EULA Securitized Coml Mort (Payments)	4.0%

Note 1. For “non-FI/FI Issued ABCP (High rated)”, only ABCPs accepted at the central banks in Canada and U.S. are eligible for the 7.5% haircut noted above.

Appendix 2: Summary Run-Off Rates and Assumptions

Reference	Balance Sheet Items	Assumptions		
		Month 1 or initial maturity	Month 2-12 or subsequent maturities	>12 Months
Assets		Inflows		

Eligible Unencumbered Liquid Assets

(Haircuts are prescribed in the Securities Haircut Table – Appendix 1)

NHA MBS (includes purchased MBS and created/market MBS)	100% in month 1 after applicable haircut (4%)	Haircut (4%) of maturing inflows is recognized in contractual maturity time buckets.
Other	100% in month 1 after applicable haircut	Haircut amount is recognized at contractual maturity time

Other Cash and Investments

Deposits at Other Financial Institutions	100%
Other securities	100% at contractual maturity or the earliest option date

Other Investments	Cash inflow for dividend on declaration date.	100% >12 mths
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Performing Loans – Personal and Commercial

Mortgages (Balance at Maturity)	100% rollover at contractual maturity with NO inflow.
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Mortgages (Payments)	Contractual amortization payments are recognized as inflows in each period. Inflows from payments for month 1 will be recognized as the same inflows for month 2-12 time buckets
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Securitized Mortgages (Balance at Maturity)	No rollover. 100% at contractual maturity.
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Securitized Mortgages (Payments)	100% on payments (including interest and loan amortization)
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Term Loans	Contractual amortization payments are recognized as inflows in each period. 100% at contractual maturity. No rollover at maturity assumed.
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Line of Credit	100% at contractual maturity. No rollover at maturity assumed. Include specified minimum payments only for Line of Credit with no specific maturity
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Leases and Other	Contractual amortization payments are recognized as inflows in each period 100% at contractual maturity; No rollover at maturity assumed.
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Other Assets	N/A	N/A	100%
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Liabilities		Outflows	
Retail Deposits (Personal, and Small Business)			
Stable Deposits	Insured demand deposits with established relationships or in transactional accounts	3%	1% per month on declining balance
	Insured Term deposits with established relationships or in transaction accounts	3%. Net balance rolls over with same term	1% at subsequent maturity dates on declining balance
	Other Insured demand deposits	5%	1% per month on declining balance
	Other insured term deposits	5%. Net balance rolls over with same term	1% at subsequent maturity dates on declining balance
Less Stable Deposits	Brokered Deposits –Demand	10%.	5% per month on declining balance
	Brokered Deposits	10%. Net	5% at

-term	balance rolls over with same term	subsequent maturity dates on declining balance
Uninsured demand deposits	10%	5% per month on declining balance
Uninsured term deposits	10%. Net balance rolls over with same term	5% at subsequent maturity dates on declining balance

Unsecured Wholesale Deposits

All term deposits (original term >30days)	100% at initial maturity. No rollover	N/A
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Other demand and term deposits with current term of 1 month or less)

Operational Deposits- Insured	3%	3% per month on declining balance
Operational Deposits- uninsured	10%	5% per month on declining balance
Non-operational deposits – insured	12.5%	5% per month on declining

			balance
Non-operational deposits - uninsured	12.5%		10% per month on declining balance
Non-operational deposits from financial institutions and other legal entities	100% at month 1		N/A

Borrowings and Other Liabilities

Central 1 or League – Operating/Clearing account	100%		N/A
Central 1 or League – Term Borrowings			100% at contractual maturity date
Other Borrowings (including securitizations)			100% at contractual maturity date
Other liabilities	N/A	N/A	100%
Equity			
	N/A	N/A	100%

Appendix VI – Proposed Completion Guide: Net Stable Funding Ratio

Guidance



Effective Date: January 1, 2021

Identifier: No. CU0068APP

Net Stable Funding Ratio Completion Guide

Purpose

The Net Stable Funding Ratio (NSFR) is a standard that will require credit unions to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. This Approach Guidance provides credit unions with a guide to be used with the calculation and the reporting of the NSFR.

Scope

This Approach Guidance affects the following entities regulated by FSRA:

- Credit Unions and Caisses Populaires incorporated under the *Credit Union and Caisses Populaires Act, 1994* (the Act)

This Guidance complements the information provided in, and should be read in conjunction with, other FRSA guidance and supporting publications available on FSRA's website (www.fsrao.ca).

Approach

Processes and Practices

Introduction

1. The Net Stable Funding Ratio (NSFR) is a standard that will require credit unions to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. A sustainable funding structure is intended to reduce the likelihood that disruptions to a credit union's regular sources of funding will erode its liquidity position in a way that would increase the risk of its failure and potentially lead to broader systemic stress. The NSFR aims to limit over-reliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance sheet items, and promotes funding stability. In addition, the NSFR approach offsets incentives for institutions to fund their stock of liquid assets with short-term funds that mature just outside the Liquidity Coverage Ratio (LCR)'s 30-day horizon.

Assumptions

2. The amounts of available and required stable funding specified in the standard are calibrated to reflect the presumed degree of stability of liabilities and liquidity of assets. The NSFR is generally calibrated such that longer-term liabilities are assumed to be more stable than short-term liabilities. The NSFR is calibrated under the assumption that short-term (maturing in less than one year) deposits provided by retail customers and funding provided by small business customers are more stable than wholesale funding of the same maturity from other counterparties.
3. In determining the appropriate amounts of required stable funding for various assets, the following criteria were taken into consideration, recognising the potential trade-offs between these criteria:
 - The NSFR requires stable funding for some proportion of lending to the real economy in order to ensure the continuity of this type of intermediation.
 - The NSFR is calibrated under the assumption that banks may seek to roll

- over a significant proportion of maturing loans to preserve customer relationships.
- The NSFR assumes that some short-dated assets (maturing in less than one year) require a smaller proportion of stable funding because banks would be able to allow some proportion of those assets to mature instead of rolling them over.
 - The NSFR assumes that unencumbered, high-quality assets that can be securitised or traded, and thus can be readily used as collateral to secure additional funding or sold in the market, do not need to be wholly financed with stable funding.
 - Additional stable funding sources are also required to support at least a small portion of the potential calls on liquidity arising from OBS commitments and contingent funding obligations.
4. This stress test should be viewed as a minimum requirement. Credit unions are expected to conduct their own stress tests to assess the level of liquidity they should hold beyond this minimum, and construct their own scenarios that could cause difficulties for their specific business activities. Such internal stress tests should incorporate different factors to test the impacts of potentially lower availability of the more significant funding sources.
5. The NSFR has two components:
- a. Available amount of stable funding; and
 - b. Required amount of stable funding, calculated according to the scenario parameters outlined below.
6. The NSFR is defined as the amount of available stable funding relative to the amount of required stable funding. The ratio should be at least equal to 100% on an ongoing basis. Available stable funding is defined as the portion of capital and liabilities of the credit union that is expected to be reliable over the time horizon of the NSFR. Required stable funding is a function of the liquidity characteristics and residual maturities of assets and off-balance sheet exposures of the credit union.

7. NSFR definitions mirror those outlined in the LCR publications, unless otherwise specified. All references to LCR definitions in the NSFR refer to the definitions outlined in the LCR documents.

Available stable funding

8. The amount of available stable funding (ASF) is measured based on the broad characteristics of the relative stability of an institution's funding sources, including the contractual maturity of its liabilities and the differences in the propensity of different types of funding providers to withdraw their funding. The amount of ASF is calculated by first assigning the carrying value of an institution's capital and liabilities to one of five categories as presented below. The amount assigned to each category is then multiplied by an ASF factor, and the total ASF is the sum of the weighted amounts. Carrying values represent the amount at which a liability or equity instrument is recorded before the application of any regulatory deductions, filters or other adjustments.

Liabilities and capital receiving a 100% ASF factor

9. Liabilities and capital instruments receiving a 100% ASF factor comprise:
 - a. the total amount of regulatory capital, before the application of capital deductions, excluding the proportion of Tier 2 instruments with residual maturity of less than one year;
 - b. the total amount of any capital instrument not included in (a) that has an effective residual maturity of one year or more, but excluding any instruments with explicit or embedded options that, if exercised, would reduce the expected maturity to less than one year; and
 - c. the total amount of secured and unsecured borrowings and liabilities (including term deposits, NHA MBS (CMB) with effective residual maturities of one year or more. Cash flows falling below the one-year horizon but arising from liabilities with a final maturity greater than one year do not qualify for the 100% ASF factor.

Term deposits that allow for annual redemption without penalty are treated as maturing at the next anniversary date.

Liabilities receiving a 95% ASF factor

10. Liabilities receiving a 95% ASF factor are “stable” (insured) non-maturity demand deposits and term deposits (as defined in the LCR) with residual maturities of less than one year provided by retail and small business members.

Liabilities receiving a 90% ASF factor

11. Liabilities receiving a 90% ASF factor are “less stable” (uninsured) non-maturity (demand) deposits and term deposits, large deposit and other deposits (as defined in the LCR) with residual maturities of less than one year provided by retail and small business customers.

Liabilities receiving a 50% ASF factor

12. Liabilities receiving a 50% ASF factor are:

- a. funding (secured and unsecured) with a residual maturity of less than one year provided by non-financial corporate customers;
- b. operational deposits;
- c. funding with residual maturity of less than one year from sovereigns, public sector entities (PSEs), and multilateral and national development banks; and
- d. other funding (secured and unsecured) not included in the categories above with residual maturity between six months to less than one year, including funding from central banks and financial institutions.

Liabilities receiving a 0% ASF factor

13. Liabilities receiving a 0% ASF factor are:

- a. all other liabilities and equity categories not included in the above categories, including net derivative liabilities, other funding with residual maturity of less than six months from central banks and financial institutions; and
- b. other liabilities without a stated maturity.

Calculation of derivative liability amounts

14. Derivative liabilities are calculated first based on the replacement cost for derivative contracts (obtained by marking to market) where the contract has a negative value. When an eligible bilateral netting contract is in place, the

replacement cost for the set of derivative exposures covered by the contract will be the net replacement cost.

15. In calculating NSFR derivative liabilities, collateral posted in the form of variation margin in connection with derivative contracts, regardless of the asset type, must be deducted from the negative replacement cost amount.

Required stable funding

16. The amount of required stable funding is measured based on the broad characteristics of the liquidity risk profile of an institution's assets and OBS exposures. The amount of required stable funding is calculated by first assigning the carrying value of an institution's assets to the categories listed. The amount assigned to each category is then multiplied by its associated required stable funding (RSF) factor, and the total RSF is the sum of the weighted amounts added to the amount of OBS activity (or potential liquidity exposure) multiplied by its associated RSF factor. Definitions mirror those outlined in the LCR, unless otherwise specified.
17. The RSF factors assigned to various types of assets are intended to approximate the amount of a particular asset that would have to be funded, either because it will be rolled over, or because it could not be monetised through sale or used as collateral in a secured borrowing transaction over the course of one year without significant expense. Under the standard, such amounts are expected to be supported by stable funding.
18. Assets should be allocated to the appropriate RSF factor based on their residual maturity or liquidity value. For amortising loans, the portion that comes due within the one-year horizon can be treated in the less-than-one-year residual maturity category.

Encumbered assets

19. Assets on the balance sheet that are encumbered for one year or more receive a 100% RSF factor. Assets encumbered for a period of between six months and less than one year that would, if unencumbered, receive an RSF factor lower than or equal to 50% receive a 50% RSF factor. Assets encumbered for between six months and less than one year that would, if unencumbered, receive an RSF

factor higher than 50% retain that higher RSF factor. Where assets have less than six months remaining in the encumbrance period, those assets may receive the same RSF factor as an equivalent asset that is unencumbered.

Secured financing transactions

- 20.** For secured funding arrangements, use of balance sheet and accounting treatments should generally result in credit union's excluding, from their assets, securities which they have borrowed in securities financing transactions (such as reverse repos and collateral swaps) where they do not have beneficial ownership. In contrast, credit unions should include securities they have lent in securities financing transactions where they retain beneficial ownership.
- 21.** Credit unions should also not include any securities they have received through collateral swaps if those securities do not appear on their balance sheets. Where credit unions have encumbered securities in repos or other securities financing transactions, but have retained beneficial ownership and those assets remain on the balance sheet, the credit union should allocate such securities to the appropriate RSF category.

Calculation of derivative asset amounts

- 22.** Derivative assets are calculated first based on the replacement cost for derivative contracts (obtained by marking to market) where the contract has a positive value. When an eligible bilateral netting contract is in place the replacement cost for the set of derivative exposures covered by the contract will be the net replacement cost.
- 23.** In calculating NSFR derivative assets, collateral received in connection with derivative contracts may not offset the positive replacement cost amount, regardless of whether or not netting is permitted under the bank's operative accounting or risk-based framework, unless it is received in the form of cash variation margin. Any remaining balance sheet liability associated with (a) variation margin received that does not meet the criteria above or (b) initial margin received may not offset derivative assets and should be assigned a 0% ASF factor.

Assets assigned a 0% RSF factor

24. Assets assigned a 0% RSF factor are unencumbered Level 1 HQLA as defined in the LCR (excluding assets receiving a 5% RSF as noted below):

- a. cash on hand and immediately available to meet obligations;
- b. all claims on central banks with a 0% risk weight including marketable securities (e.g. NHA MBS) with residual maturities of less than six months.

Assets assigned a 5% RSF factor

25. Assets assigned a 5% RSF are unencumbered Level 1 HQLA noted in paragraph 24 (b) above with residual maturities of 6 months to 1 year.

Assets assigned a 10% RSF factor

26. Assets assigned a 10% RSF factor are unencumbered loans to financial institutions with residual maturities of less than six months, where the loan is secured against Level 1 assets as defined in the LCR and where the bank has the ability to freely rehypothecate the received collateral for the life of the loan.

Assets assigned a 15% RSF factor

27. Assets assigned a 15% RSF factor are:

- a. unencumbered Level 2A HQLA assets as defined in the LCR including:
 - marketable securities representing claims on or guaranteed by sovereigns, central banks, PSEs or multilateral development banks that are assigned a 20% risk weight under the Basel II standardised approach for credit risk; and
 - corporate debt securities (including commercial paper) and covered bonds with a credit rating equal or equivalent to at least AA-;
- b. all other unencumbered loans to financial institutions with residual maturities of less than six not included in 4.3.

Assets assigned a 50% RSF factor

28. Assets assigned a 50% RSF factor are:

- a. unencumbered Level 2B HQLA assets including:

- residential mortgage-backed securities (RMBS) with a credit rating of at least AA;
 - corporate debt securities (including commercial paper) with a credit rating of between A+ and BBB–; and
 - exchange-traded common equity shares not issued by financial institutions or their affiliates;
- b. any HQLA as defined in the LCR that are encumbered for a period of between six months and less than one year;
 - c. all loans to financial institutions and central banks with residual maturities between six months and less than one year;
 - d. deposits held at other financial institutions for operational purposes, as outlined in LCR guidance; and
 - e. all other non-HQLA not included in the above categories that have a residual maturity of less than one year, including non-financial corporate loans and retail and small business (i.e. natural persons) loans.

Assets assigned a 65% RSF factor

29. Assets assigned a 65% RSF factor comprise:

- a. unencumbered residential mortgages with a residual maturity of one year or more that qualify for a 35% or lower risk weight under the Basel II; and
- b. other unencumbered loans not included in the above categories, excluding loans to financial institutions, with a residual maturity of one year or more that would qualify for a 35% or lower risk weight under the Basel II.

Assets assigned an 85% RSF factor

30. Assets assigned an 85% RSF factor comprise:

- a. other unencumbered performing loans that do not qualify for the 35% or lower risk weight under the Basel II and have residual maturities of one year or more, excluding loans to financial institutions;
- b. unencumbered securities with a remaining maturity of one year or more and exchange-traded equities, that are not in default and do not qualify as HQLA according to the LCR;

Assets assigned a 100% RSF factor

31. Assets assigned a 100% RSF factor comprise:

- a. all assets that are encumbered for a period of one year or more;
- b. NSFR derivative assets;
- c. all other assets not included in the above categories, including non-performing loans, loans to financial institutions with a residual maturity of one year or more, non-exchange-traded equities, fixed assets, and items deducted from regulatory capital.

Non-performing loans are loans that are greater than 90-days delinquent.

Off-Balance Sheet Assets assigned a 5% RSF factor

32. Irrevocable and conditionally revocable credit facilities to any client are assigned a 5% RSF for the outstanding undrawn amount.

Effective Date and Future Review

This Approach Guidance became effective on January 1, 2021 and will be reviewed no later than January 1, 2024.

About this Guidance

This Guidance is an Approach. Approach Guidance describes FSRA's internal principles, processes and practices for supervisory action and application of Chief Executive Officer discretion. Approach Guidance may refer to compliance obligations but does not in and of itself create a compliance obligation. Visit [FSRA's Guidance Framework](#) to learn more.

Appendices and Reference

Appendix 1: Summary ASF and RSF Factors

Liabilities	Balance sheet items	ASF
0Capital and Liabilities with residual maturity/callable >1 year		
	Regulatory Capital (Tier 1)	100%
	Term Deposits	100%
	NHA MBS	100%
	Other borrowings and liabilities	100%
Retail and Small Business Funding with residual maturity <1 year		90%
Wholesale Funding with residual maturity/callable <1 year		50%
All other liabilities and equity		0%
Assets	Balance Sheet Items	RSF
Level 1 HQLA	Cash on Hand/Reserves/NHA MBS <6 months	0%
	NHA/MBS < 6 months	5%
Level 2A HQLA	Marketable securities (20% RW), Qualifying Corporate debt	15%
Level 2B HQLA	Marketable securities/ Qualifying Corporate debt and equity securities	50%
Deposits	Operational Deposits at FIs	50%
Performing loans to FIs with residual maturity/callable <6 months		
	loan secured against Level 1 assets collateral can be rehypothecated	10%

	Other loans	15%
Performing loans with residual maturity/callable <1 year		50%
Loans with residual maturity/callable >1 year		
	Residential mortgages and other loans RW 35% or less	65%
	Other Loans	85%
	Non-performing loans	100%
All other assets		100%
Off-Balance Sheet Assets	Undrawn LOC	5%