September 14, 2021

FSRA Policy Division
25 Sheppard Ave W. Suite 100
Toronto, ON
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Delivered by e-mail

Dear FSRA Policy Team,

RE: Response to FSRA's Draft Rule 2021 – Liquidity Adequacy Rule (LAR)

Thank you for the opportunity to provide comments to FSRA's Draft Liquidity Adequacy Rule ("Draft Rule" or "Rule") which we believe will help ensure that credit unions maintain and properly manage adequate liquidity to protect depositors and the Deposit Insurance Reserve Fund from undue risks. Below are our written comments which we kindly ask you to consider as you work towards the final draft of the Rule.

Alterna supports FSRA's journey towards principles-based regulation, and we feel we are uniquely positioned to provide comments on the Draft Rule given our subsidiary bank is regulated under a principles-based regime. A principles-based framework also facilitates a collaborative regulatory model, whereby Ontario's credit unions work harmoniously with FSRA to achieve desired regulatory outcomes. Over the long term, we believe that this model will enhance prudential management of a credit union's liquidity adequacy and will strengthen both idiosyncratic and systemic resiliency.

Alterna's comments are summarized below:

1. **Section 5: Liquidity Coverage Ratio (LCR)**

Alterna appreciates the efforts FSRA has made to further align the way in which credit unions determine the LCR to those standards required by OSFI regulated institutions. Having a level playing field with respect to liquidity adequacy is very important to the competitiveness of the credit union sector. However, Alterna believes that further alignment is necessary with respect to the treatment of cash inflows coming from a credit union's non-operational deposits held at other financial institutions.

Credit unions rely on the banking services provided by the large financial institutions in Canada (e.g. clearing, cash management, funding, lines of credit, capital markets, investments etc.) and are always looking to strengthen those relationships. It is not uncommon for the major banks in this country to offer credit unions attractive investment rates for demand deposits (High Yield

Savings Accounts) to those who have excess cash to invest. The risk/return characteristics of these investments are often very favorable for credit unions, yet they receive unfavorable liquidity treatment. For the purposes of calculating the LCR, these demand deposits are treated as cash inflows whose value is subject to the 75% inflow cap in relation to the value of cash outflows.

We recommend that FSRA further aligns the LCR methodology to OSFI's standards for indirect clearers. More specifically, for the purposes of determining a credit union's cash inflows, non-operational demand deposits placed with an OSFI regulated direct clearer should receive a cash inflow value of 100% and not be subject to the 75% cap on cash outflows.

2. **Section 10: Internal Liquidity Adequacy Assessment Process (ILAAP)**

The ILAAP requirements described in the Draft Rule are largely "*principles-based and outcomes focused*". Consistent with Internal Capital Adequacy Assessment Process (ICAAP) provisions and its evolution, credit unions will need time to build an implementation roadmap and decide priorities in their efforts to design and implement an effective and efficiently robust ILAAP framework. Additionally, the ILAAP will need to be integrated into the organization's overall enterprise risk management framework (governance, risk appetite/tolerance, risk culture, policies, guidelines etc.), along with a focused analysis on potential impacts to business strategy and the organization's potential risk profile.

FSRA has stated that, according to its own analysis, all Ontario credit unions already comply with the proposed liquidity adequacy requirements in the Draft Rule. Alterna notes, however, that there will be additional material costs incurred by credit unions as they roll-out their ILAAP frameworks (from initial design through to on-going continuous improvements). Additional cost may arise due to:

- additional investments in risk data (e.g. data definition, data quality, data alignment, data management)
- additional investments in risk modelling, metrics and stress testing
- additional oversight and audit costs

As Ontario credit unions start to develop and implement ILAAP programs, Alterna suggests that FSRA remain open to further consultation with credit unions and potential Rule amendments in the medium-to-longer term arising from actual experience.

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We trust that our comments are constructive and helpful. Thank you once again for the opportunity to share our thoughts, and for the constructive dialogue on this matter. Please feel free to reach out to us if you would like to discuss our recommendations in greater detail.

Best Regards,

Rob Paterson, President & CEO

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