FirstOntario
CREDIT UNION

FSRA Policy Team
25 Sheppard Avenue West, Suite 100
Toronto, ON
M2N 6S6

Delivered Electronically to Bradley Hodgins

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To the Readers,

The purpose of this memo is to provide a summary of FirstOntario's perspective regarding proposed Rule 2021 – 003, "*Liquidity Adequacy Requirements for Credit Unions and Caisses Populaires*" (herein referred to as the "Draft Liquidity Rule").

FirstOntario appreciates and supports FSRA's intention to (1) transition to principles-based regulation and (2) support modernizing the credit union liquidity governance framework applied at Ontario Credit Unions. FirstOntario also supports the transition of credit unions towards federal and international liquidity management guidance. Among many benefits, FirstOntario believes financial institutions operating under a consistent international regulatory regime, proportionally applied, advances the assessment, measurement and management of risks, mitigates counterparty risk management and improves capital markets capability.

FirstOntario also believes it is important for credit unions to operate under a level playing field. In many segments of the lending and deposit-taking markets, Ontario credit unions compete against federally regulated financial institutions. Many of the smaller institutions operating under the federal framework are largely similar from an overall risk management perspective and it is important that our methodologies for determining appropriate HQLA levels are relatively consistent with each other.

Under FSRA's guidance, the Ontario credit union system were early adopters of the key liquidity metrics introduced through the Basel III international framework, which include the Liquidity Coverage Ratio ("LCR"), the Net Stable Funding Ratio ("NSFR"), and the Net Cumulative Cash Flow ("NCCF"). While FirstOntario believes the proposed draft rule is largely consistent with current liquidity practices at credit unions and federally regulated institutions, there are a few exceptions and FirstOntario are proposing the following adjustments the draft rule.

FirstOntario Credit Union
970 South Service Road, Suite 301, Stoney Creek, Ontario L8E 6A2
Toll Free: 800-616-8878 • Fax: 905-574-6202 • FirstOntario.com

Key Issues

1. *Section 5 - LCR Calculation of Cash Inflows*

Under Section 5, the calculation of cash inflows does not clearly identify 50% of maturity payments of mortgages as a cash inflow, consistent with current guidance

Current guidance under the draft rule states the following:

"(g) Payment from a performing loan made by the credit union to a retail, small business or corporate borrower that is not a financial institution – 50% weight"

Prior guidance is more detailed, and explicitly permits a net inflow rate of the "contractual amount". The following is an excerpt from the current LCR Guidance:

"Retail, Small Businesses and Non-Financial Corporate

45. 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."

We recommend FSRA adjust the wording to account for maturities on loans, consistent with past practice and federally regulated guidance.

2. *Section 5 - LCR Calculation of Cash Outflows*

Under the draft rule, the following paragraph refers to "internet account" and does not clarify what qualifies as an internet account. For example, it is not clear whether or not an insured savings deposit account initiated by a member who was acquired digitally would count, as this also falls within the insured deposit category. As the industry is shifting more towards the use of digital technology in banking experiences, we recommend FSRA delete the reference to internet account.

"(h) Retail deposit that is a deposit not mentioned in rows (a) to (g) of Table 3, including a trust account or internet account."

3. Section 7 – Cash Inflows calculation of NCCF

Maturity payments from securitized mortgages appear not to be included in cash inflows, which does not align with OSFI guidance, creating an inequitable liquidity cost for Ontario credit unions. The following is an excerpt from the draft rule:

"(o) Payments other than balance at maturity on performing personal and commercial securitized mortgage that is not an NHA MBS."

Section 2.4 of the Net Cumulative Cash Flow Reporting Manual issued by OSFI (July 2019) clearly includes maturity values of mortgages. In line with federal and international guidance, we believe it is prudent to permit contractual maturity balances to be included as cash inflows in the NCCF calculation. These maturity balances are legally enforceable payments borrowers are contractually obligated to settle. Excluding these balances attracts a higher liquidity cost to Ontario credit unions and is not supportive of a competitive environment.

4. Internal Liquidity Adequacy Assessment Process

The draft liquidity rule outlines a requirement to implement an Internal Liquidity Adequacy Assessment Process ("iLAAP"). An iLAAP process is fairly extensive, similar to an internal capital adequacy assessment ("iCAAP"). While we agree with its implementation into the Ontario credit union system, we propose the following:

(1) Prior to implementation, extensive guidance be provided to guide credit unions on the iLAAP process. Perhaps this could include a application guide and template to complete. The draft liquidity rule provides just one page of requirements for the iLAAP, but FSRA has provided 38 pages of guidance for the iCAAP along with a template. This will help ensure consistency and adequate application of iLAAP among credit unions.
(2) Provide a transition timeline of at least one year for the iLAAP, after publishing the necessary materials to provide adequate guidance to credit unions.

<u>Conclusions</u>

We wish to thank you for the opportunity to comment on the draft liquidity rule. Generally, we found the draft rule requirements to be largely consistent with our current practices. FirstOntario is also pleased with the introduction of an iLAAP process into the credit union system, which will promote over the long term liquidity risk assessment and sustainability.

Best,

Lloyd Smith, CPA, CGA, CCE Chief Executive Officer
FirstOntario Credit Union