CCUA ACCF
Canadian Credit Union Association
Association canadienne des coopératives financières

20 Queen Street West
Suite 2301A
Toronto, ON M5H 3R4
Tel: / Tél. : 416.232.1262
Fax: / Téléc : 416.232.9196

ccua.com

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Catherine Tam
Financial Services Regulatory Authority
25 Sheppard Avenue West, Suite 100
Toronto, ON M2N 6S6

RE: Proposed Risk Based Supervisory Framework

Dear Ms. Tam,

The Canadian Credit Union Association is the trade association for Ontario's credit unions and caisses populaires. We offer the following feedback to the proposed Risk Based Supervisory Framework (RBSF).

We believe that FSRA is taking the right approach in using a non-prescriptive approach. Once finalized, the RBSF framework will be an effective way to determine oversight plans based on the nature, size, complexity, and risk profile of the credit union. The RBSF is comprehensive enough to ensure high standards of business conduct and protect the interests of members, while also providing the necessary flexibility for credit unions to remain competitive.

While overall supportive of the RBSF, we do have several serious concerns related to the lack of defined burden reduction, issues around transparency, asymmetry of power when resolving disputes, and conflicting messaging regarding granular data collection.

These concerns will need to be addressed before we can fully support the RBSF framework. As it stands, there appears to be little benefit for credit unions, which could unjustly lead to more burdensome oversight and increased premiums.

No Burden Reduction Demonstrated

Support for the RBSF is predicated on the principle that long term efficiencies will ultimately lead to burden reduction both for credit unions and FSRA (with the understanding that the RBSF will require additional resources and effort in the short term). This principle of burden reduction was acknowledged and re-affirmed by FSRA during the last Technical Advisory Committee (TAC) meeting.

However, potential outcomes prescribed in the consultation paper appear to lead to either increased oversight and higher DIRF premiums or maintaining current oversight with steady Deposit Insurance Reserve Fund (DIRF) premiums.

As noted in Appendix C of the consultation paper, dependant on the overall risk rating (ORR), credit unions will be assigned an intervention level ranging from 1-5, which will guide FSRA's supervisory activities. If a credit union receives the lowest possible ORR and thus an intervention level of 1, as currently proposed, they will be subject to the following supervisory actions by FSRA:

- Periodic examinations and on-site reviews.
- Monitoring of select information on a monthly, quarterly and/or annual basis.
- Providing the CU with a supervisory letter annually.
- Other supervisory activities as required or at the discretion of the supervisory team.

These supervisory outcomes suggest that even if a credit union fully minimizes their residual risk and receives the lowest ORR possible, no burden reduction is prescribed. As credit unions move to higher ORRs, they'll be subject to progressively stricter oversight including higher insurance premiums, higher capital and liquidity premiums, greater requirements around data reporting and frequency, etc. This means the only outcomes for credit unions is equal or greater oversight, which completely neglects the intended outcome of burden reduction.

The lack of prescribed outcomes towards burden reduction undermines credit union support for the RBSF and contradicts what FSRA communicated to credit unions at the last TAC meeting. To better support the objectives of the RBSF and align FSRA and credit unions' goals, we recommend that the supervisory outcomes based on a credit union's ORR be amended so that the lower levels of risk include burden reduction measures, such as (but not limited to):

- Reduced insurance premium assessments (top-priority)
- Less frequent examinations
- Reduced data reporting requirements

It's imperative that these burden reductions are quantifiable and directly tied to risk-reducing actions from credit unions. Without burden reduction, the objectives of the framework are not achieved and FSRA and credit union goals become misaligned.

<u>The Dispute Resolution Mechanism</u>

It is inevitable that credit unions will occasionally dispute their ORR given the non-uniform and non-prescriptive approach to determining residual risk. For credit unions to have confidence in the RBSF process, it's necessary that the dispute resolution process is impartial. In the consultation document FSRA suggests that if a credit union disputes the ORR assigned by their relationship manager, the credit union can escalate the process within FSRA.

FSRA staff should not be the ones resolving a dispute between a credit union and a FSRA relationship manager. The asymmetry of power between FSRA and the credit union in this situation undermines the validity and trust credit unions have in the process.

Variability Between Assessments

Given that there will be multiple relationship managers assigning risk ratings to credit unions, there is a concern that non-uniformities in each relationship managers assessment processes will lead to inconsistent risk ratings (i.e., some risk managers may be more heavy-handed with their assessment decisions).

FSRA should periodically audit and/or perform cross-comparisons between relationship managers as appropriate to ensure consistency.

Transparency Concerns

In the consultation paper, FSRA states their intention to use RBSF outcomes to calculate DIRF premium assessments with greater accuracy. CCUA's September 2021 response to the DIRF consultation detailed our key opposition to the ever-increasing levels of subjectivity and ambiguity in how premiums are calculated. By including the RBSF in the calculation process without providing a formula that outlines exactly how the RBSF score will impact premium assessments, another layer of uncertainty is added and the premium assessment process becomes an even more ambiguous for credit unions.

In meeting with British Columbia's stakeholders to learn about their assessment process, we learned that credit unions in their jurisdiction receive the following from their regulator:

- A detailed model which shows how deposit premiums are calculated based on financial and quantifiable data points (Quantifiable Model)
- A detailed model which shows how their RBSF score is calculated (RBSF Model)
- An equation which shows how the Quantifiable Model and RBSF Model are combined to calculate the final risk premium.

FSRA's divergence from other provinces and the unwillingness to be clear on how premium assessments are calculated is becoming a top concern for the sector. Without transparency, trust in the current premium assessment process won't be achieved. Credit unions should not have to pay premiums based on a methodology that they are not privy to.

We recommend that FSRA share details of their premium calculations, comparable to the practice in BC, for credit unions to understand and support providing information to these risk models.

Conflicting Messaging About Granularity of Data and Risk Assessments

CCUA believes that FSRA is taking the right approach in using a non-prescriptive approach. However, we are concerned that while taking the non-prescriptive approach with the RBSF, FSRA is simultaneously pushing for ever increasing access to data at more granular levels with greater frequency. The objective of the RBSF is to minimize burden and reduce oversight for credit unions with low-risk profiles and strong risk controls. Yet, FSRA's simultaneous push for loan level/product level data conflicts with the objectives of the RBSF.

The level of granularity of data that FSRA is pushing for in other areas should not be applicable to credit unions with low ORRs and, if anything, should only be reserved for those credit unions that require enhanced supervision.

Specific Comments

We are providing the following comments on specific provisions proposed in the framework:

"FSRA will assess the stature and authority of the executive leadership (heads) of the Oversight Functions within the organization and the extent to which they are independent from operational management. FSRA will look to ensure that the heads have unfettered access and a functional reporting line to the Board or the appropriate Board committee." (p. 10)

This appears to be in contradiction to the Sound Business and Financial Practices Rule, which states that the oversight function heads report to the CEO. Only the internal audit heads report to the Audit Committee of the Board and not the Chief Financial Officer, Chief Risk Officer, and such.

"FSRA assesses the capital adequacy of a CU on both a current (at time of assessment) and forward-looking time frame (e.g., how expected earnings would affect the capital position)." (p. 12)

Capital and earnings are combined as one consideration and earnings are only defined as stated above. Profitability trends and current/future earning capacity, while a key determinant in building and maintaining capital (allocations to undivided earnings, payment of dividends on shares), also reflect a significant portion of a CU's overall risk profile, separate from capital levels.

We recommend that profitability and earnings, while related to capital, should have greater recognition in this section.

"Credit unions must consider their exposure to Environmental, Social and Governance (ESG) risks and assess their effects on capital." (p. 12).

"Credit unions must consider their exposure to Environmental, Social and Governance (ESG) risks and assess their effects on liquidity." (p. 12).

"A resilient CU is expected to anticipate future threats and opportunities including being able to identify and manage ESG risks." (p. 13).

While we recognize the importance of considering ESG risks on capital, liquidity, and how it is applied to broader threats and opportunities – the timing to introduce such provisions is premature. The credit union sector has not been consulted on ESG considerations to date and FSRA could embark on a better process to ensure the sector is ready to take on the new considerations to the satisfaction of the regulator.

Not only will credit unions need to invest in significant financial resources or outsource the work to sufficiently consider their exposures but there is also ambiguity as to what FSRA is expecting (i.e., how is ESG defined according to FSRA? How does FSRA expect credit unions to consider ESG exposures?).

We recommend that FSRA remove this provision from the framework and mirror OSFI's process for climate risk management guidance, where appropriate to the Ontario credit union sector. OSFI has outlined seven initiatives ahead of introducing ESG requirements:

1. Drafting a guideline for federally regulated FIs climate risk management for consultation. The draft will outline OSFI's risk management expectations.

2. OSFI plans to complete its analysis of data gaps in its regulatory returns and assess the availability of additional climate related quantitative and qualitative data.

3. Build standardized climate scenario analysis and stress testing exercises to assess the impacts of both physical and transition risks.

4. Continue to assess whether its regulatory capital framework needs to reflect the features of climate-related financial risks.

5. Monitor the progress of domestic and international initiatives to standardize disclosures and assess market readiness for mandatory climate-related financial disclosures.

6. Look for opportunities to broaden stakeholder engagement as OSFI plans to address climate-related financial risks.

7. Expand OSFI's capability in the regulation and supervision of climate-related financial risks.

"FSRA periodically requires CUs to perform specific stress tests that FSRA uses to assess the potential impact of changes in the operating environment on individual CUs or industries. Environmental scanning and stress testing have increased in importance as changes in the external environment are a main driver of rapid changes in CU risk profiles. FSRA may also request the CU's internal auditor, or at the CU's expense, its external auditor, or other external resource (e.g., consulting firm) to investigate and report on a matter to FSRA." (p. 15).

We are concerned that credit union resources may be required to report directly back to FSRA on certain matters – especially as this has not been scoped out.

Furthermore, and as echoed in submissions from the sector in the Standards of Sound Business and Financial Practices consultation, this provision will see the senior management of credit unions bypassed.

"*Controls and oversight assessment: When assessing the characteristics and performance of each function, FSRA considers, at a minimum, the following essential elements."* (p. 28).

We recommend adding Board Policies and Strategic Business Plan as an essential element under Board of Directors, as well as adding Operational and Capital Budgets and Management Policies and Procedures under Senior Management.

We also recommend that the guidance rely on a review of a credit union's Enterprise Risk Management (ERM) program as a primary source and input to the RBSF risk assessment process. A credit union's ERM activities already include considerations to reporting, mitigation efforts, risk appetite statement, etc. – this should be included in this framework.

Finally, CCUA recommends the inclusion of the 'three lines of defence' concept in the proposed framework. While mentioned in the guiding principles of the Market Code of Conduct and the proposed Standards of Sound Business and Financial Practices, we believe the inclusion of the concept in this framework will create alignment with OSFI and ensure further effective accountability.

Concluding Remarks

While several challenges were raised above, we would like to re-iterate our view that FSRA is taking the right approach in using a non-prescriptive approach. Once the issues articulated above are resolved, we believe the framework will be beneficial to FSRA, credit unions, and most importantly, the consumers.

We look forward to tackling issues of defining burden reduction outcomes, improving transparency, reducing asymmetries of power, and clarifying objectives around data collections. Once resolved, we will be fully able to support the RBSF, marking a great step in the right direction for the sector.

If you have any questions, please don't hesitate to reach out.

Sincerely,

Sabena Sandhu
Policy Analyst, ON Government Relations
Canadian Credit Union Association (CCUA)