Credit Union consultation on the Deposit Insurance Reserve Fund Adequacy Assessment Framework Consultation

Desjardins Group submission

Submitted to the Financial Services Regulatory Authority of Ontario

September 9, 2021

The Desjardins Group ("Desjardins") is pleased to respond to the request for comment on the Deposit Insurance Reserve Fund ("DIRF") Adequacy Assessment Framework Report for the Ontario credit union and caisse populaire sector (the "sector").

Desjardins is the leading cooperative financial group in Canada serving over 7.5 million members and clients and with $389 billion in assets[1]. We provide Canadians with wealth management, life and health insurance, property and casualty insurance, and personal, business, and institutional financial services such as payment processing. In Ontario, the Desjardins Ontario Credit Union ("DOCU") is the second largest credit union in the province with 130,000 members, 51 branches, over $8 billion in assets, and over $17 billion in assets under management. For over 120 years, Desjardins has listened and responded to its members' needs, adapted to change, and weathered the storms.

Desjardins welcomes FSRA's engagement of the credit union sector on its ongoing work on the DIRF Framework and model and its proposed enhancements. We agree that the DIRF's adequacy is vital to the sector's stability and appreciate FSRA's recognition of the cost to the sector that hinders our use of capital for the benefit of our members or for our growth. We also support FSRA's aim "to better balance the need for a DIRF that is sufficient to ensure deposit protection and stability while not putting an undue economic burden on the sector."[2] Our comments are provided with this viewpoint in mind.

Overall approach to the DIRF Adequacy Review Framework

The proposed general approach to assess the DIRF's adequacy seems adequate, especially as it is inclusive, relies more on accessing a broad and relevant database from the sector, and consists of covering the level of expected losses according to the risk profile of each credit union in the Ontario sector, while considering different crisis contexts. We also recognize the change in method for the assessment of the DIRF is inspired by the best international practices (IADI). We would welcome a discussion on the question of the suitability of the risk assessed for each credit union and the established deposit insurance premium amounts to be paid by individual credit unions because the implications of the cost structure of the annual deposit insurance premium payable by each credit union are not clear. We believe the aim should be an equitable, not equal, sharing of the financing burden of the DIRF based on the degree of risk that a credit union imposes on the fund, and on the level of capital available within the credit union, especially in the event of a recalibration of the annual premium amounts.

Considering FSRA's goal is to foster a sustainable and competitive financial services sector, Ontario credit unions' deposit insurance premiums should not represent a heavier burden than the one carried by their federally chartered competitors. A significant difference in premiums between jurisdictions favours some financial institutions over others, resulting in an unbalanced playing field and a handicap to the sector's competitiveness. Federally chartered financial institutions have a very strong presence in Ontario and are the strongest competition to the sector. For this reason, the inclusion of a comparison with the federal deposit insurance reserve fund, its balance, its size and target as a percent of Insured Deposits, and the premiums paid to the Canada Insurance Deposit Corporation (CIDC) would be informative, similar to the table presented in Appendix 1. Additionally, an analysis showing the effects on the DIRF of a cap on dues equivalent to the federal level would be welcomed.

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[1] Based on Q2 2021 results.

[2] https://www.fsrao.ca/industry/credit-unions-and-caisses-populaires/publications/deposit-insurance-reserve-fund-adequacy-assessment-framework-report#background

Asking Ontario credit unions to pay more would hinder our sustainability and competitiveness, which ultimately has a negative impact on the members we serve. This is why Desjardins hopes to avoid further increases to our DIRF premium. Moreover, in our view, it is undeserved for the credit unions who have implemented the necessary measures that result in a low risk profile to have to subsidize, in the end, credit unions who expose the sector to risk. A weakened or vulnerable credit union affects the members of the stronger and more resilient credit unions because we must reallocate resources that could instead be invested in our communities, in growth or innovation, or to enhance our services and better serve our members. In our view, the credit unions who successfully manage risk should be rewarded with a lower premium and the credit unions that pose a higher risk to the sector should have higher contributions to the DIRF. This would promote a higher standard of business conduct, which ultimately, would benefit the entire sector and foster its sustainability.

To achieve these aims, we recommend a much stronger correlation between a credit union's deposit insurance differential premiums and its risk profile. In our view, this approach would provide more incentives for a credit union to better manage its risks while continuing to serve its members. Furthermore, currently 36% of the Differential Score Determination is linked to management. It would be informative to know the sector's average, and if the current assessment is an accurate predictor of risk.

Additionally, the proposed approach's framework is similar to an *advanced risk assessment* methodology that appears to be ahead of the risk approach for the measurement of regulatory capital. A preferred scenario would be one with the alignment of the methods and the elimination of the two-speed approach. The difference in methods could generate an additional significant burden with regards to the collection of the risk data required for the DIRF and for regulatory disclosure. For this reason, and in the spirit of transparency, we recommend the consideration of establishing a formal guideline for the evaluation of the DIRF's adequacy.

The methodology

With regards to the development of stress testing scenarios and the key macroeconomic variables to follow, we recommend adding the consumer price index in the macroeconomic variables as well as the rate differentials between corporate bonds and government bonds. This last variable could be informative because increasing spreads between corporate and government bond yields usually signal worsening economic conditions, which translates into higher default rates.

For the risk rating parameters, the diversification aspect appears oversimplified. Diversification between the three major segments is not necessarily representative of the actual diversification within portfolios. We recommend integrating notions of sectoral, geographic, and "single name" concentrations to provide a more accurate picture. Secondly, in calculating the efficiency ratio, it was not clear to us whether recurring and non-recurring expenses were differentiated. A clarification would be welcomed.

We also recommend the consideration of crisis scenarios other than COVID-19 because this ongoing crisis could subside and make room for other vulnerabilities in the coming years. When considering COVID-19, it is important to factor the reactions of the various levels of government that enhanced liquidity and minimized overall risks. Because of this, it would be beneficial to consider a crisis scenario that does not include such significant government support.

Request to obtain and incorporate additional risk data to enhance the model and refine the DIRF

Most of the data requested could be available on a monthly basis to make option 1 possible. However, obtaining historical data, especially over a complete economic cycle, raises important challenges. As this is a considerable request to the sector, we recommend a slower and simpler approach to allow effective change management, and thus, to proceed with option 3 as a starting point. Once the processes and systems are validated, FSRA could re-engage the sector to discuss moving to option 2, and so on.

Principle of proportionality

Desjardins strongly supports FSRA's principle of proportionality, whereby initiatives are tailored to the structure, size, complexity, and risk profile of the institution. This aligns with our recommendation for differential DIRF premiums to be better correlated with a credit union's risk profile.

The Desjardins Group's commitment of support to the DOCU, notably as part of its risk mitigation strategies, significantly affects DOCU's risk profile. The financial solidarity mechanisms in place at Desjardins aim to ensure that members of the Group support each other *before* any intervention by the regulator is needed. In our view, it is essential that this be considered in the risk assessment of the DOCU and in its DIRF premium. We must emphasize that the only way to have an accurate portrait of the DOCU is to look at it as a component of the Desjardins Group, and not in isolation from it. This means that the DOCU's available capital, through its affiliation with the Desjardins Group, must be integrated in its risk analysis.

In 2013, the entire Desjardins Group was designated as a "domestic systemically important financial institution" ("D-SIFI") in accordance with the criteria set out by the *Basel Committee on Banking Supervision*.[3] The D-SIFI status resulted in greater supervision and a specific bail-in regime, as well as additional capitalization and disclosure requirements. The designation also required that all of Desjardins' operations, including its operations in Ontario, be subject to the D-SIFI requirements. As a result, the DOCU, with its activities in Ontario and thus regulated and supervised by FSRA, benefits from a strict regime of requirements and enhanced supervision due to the combination of the D-SIFI designation of the Desjardins Group, and the legislative, regulatory, and supervision framework in place in Ontario. This reality contributes to the DOCU's financial stability and low-risk profile, which in turn benefits the Ontario sector. By building a bridge between its available capital and its risk rating, the probabilities of the DOCU not complying with FSRA's regulatory thresholds or needing to access the DIRF are minimal.

In conclusion, we acknowledge the DIRF's importance for the resiliency of the sector and appreciate FSRA's engagement on its adequacy assessment framework. We continue to support a principles-based approach and emphasize how a comprehensive and accurate picture of the DOCU can only be obtained by recognizing its affiliation to the Desjardins Group. We hope our comments are helpful and welcome the opportunity to discuss our recommendations in further detail.

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[3] https://lautorite.qc.ca/en/general-public/media-centre/news/fiche-dactualites/amf-identifies-desjardins-group-as-asystemically-important-financial-institution-for-quebec-1