

Central 1 Credit Union Comments on the Financial Services Regulatory Authority's Proposed Capital and Liquidity Adequacy Requirements Rules

September 14, 2021

Thank you for the opportunity to provide comments to the Financial Services Regulatory Authority (FSRA) on the proposed Capital and Liquidity Adequacy Requirements Rules. Central 1 Credit Union (Central 1) appreciates the robust consultation process and FSRA's willingness to hear from parties, especially those most directly impacted by the proposed rules, such as the Ontario credit union system as a whole and Central 1.

Central 1 strongly supports the submissions made by the Canadian Credit Union Association (CCUA) on behalf of the Ontario credit union system regarding the proposed rules and wishes to submit the below additional and elaborating comments.

Comments on Proposed Capital Adequacy Requirements Rule ***Risk weighting of Ontario credit union investment holdings of shares in Central 1***

Subsection 7(3) of the proposed rule states "Any investment or asset not specified in the Proposed Rule will have a risk weighting of 1250%, unless the Chief Executive Officer specifies a different risk weighting pursuant to section 80 of the Act." The proposed rule does not appear to specify investments in Central 1's membership shares as being exempt from this weighting, which conceivably would lead them to carry a 1250% risk weight.

Central 1 sees significant potential impacts if our membership shares were to carry this risk weight, including the potential weakening of the credit union system over time, and a potential negative impact to our credit union members' capital adequacy ratios.

The foundation of a successful cooperative system is the banding together of similar entities to aggregate services and achieve economies of scale, helping all members be more competitive. The central credit unions were formed to create this scale for credit unions and realize the cost efficiencies that arise from it. Membership in the central credit union allows credit unions to be competitive, thereby strengthening them financially and reducing financial risks.

The application of a 1250% risk weight would presumably be intended to protect financial institutions against contagion or other associated risks. If a 1250% risk weighting were applied to membership shares in Central 1, it may provide an incentive for credit unions to invest less in their central, thereby reducing the scale that creates cost efficiencies, increasing financial risk and weakening the credit union system. Ultimately, this undermines the benefit / policy objective the 1250% risk weight would be intended to achieve.

An additional consideration is that Central 1's Class A shares carry a mandatory share call option which requires members to invest more capital in Central 1 when needed. Although highly unlikely, if this capital call were needed and the shares were given a 1250% risk weight, there could be adverse impacts to credit unions' capital adequacy ratios during a time of volatility.

Based on the above, Central 1 strongly advocates for the lowest risk weighting possible to be specified for member shares with Central 1, in order to reinforce the strength and resilience of the Ontario credit union system. Central 1 supports CCUA's recommendation that an appropriate and specific risk weighting for Ontario credit union investment holdings of shares in Central 1 should be added to Table 2 of the proposed rule, and that based on Central 1's current credit ratings from DBRS and Fitch¹, the applicable risk weighting could be 50% per Table 4 in the proposed rule. A 50% risk weighting also aligns with the Office of the Superintendent of Financial Institutions' (OSFI's) risk weighting assignment based on credit rating.

¹ Central 1's credit ratings are A (high) from DBRS and A- from Fitch.

Risk weighting of Ontario credit union deposits at Central 1

Section 7 of the proposed rule states that “[d]eposits held at a credit union central will have a 20% risk weighting, as will deposits at other financial institutions.”

Central 1 respectfully submits that there are noteworthy differences among financial institutions such that they should not all be treated the same. As mentioned above, Central 1 maintains a high credit rating by two rating agencies. As well, Central 1 was designated a Domestic Systemically Important Financial Institution by our regulator which imposes stricter regulatory reporting requirements and regulatory scrutiny than other financial institutions. Both of these factors suggest that deposits placed with Central 1, and other financial institutions with similar credit ratings and/or regulatory designations be afforded a lower risk weight than 20%. As well, Central 1 suggests the financial institution risk weighting category in the proposed rule should be stratified among institutions that have a high credit rating and/or designation as a systemically important institution by their regulator and those who do not have those characteristics.

Comments on Liquidity Adequacy Requirements Rule

In addition to supporting CUA's comments on the Liquidity Adequacy Requirements rule, Central 1 has minor additional comments regarding the Net Stable Funding Ratio provisions. In Table 6 of FSRA's proposed rule, Level 1 assets are assigned different Required Stable Funding (RSF) factors depending on maturity (0% for Level 1 assets maturing within six months, 5% for Level 1 assets with a residual maturity between six months and one year, and no specific RSF factor for Level 1 assets with a maturity greater than 1 year.) Central 1 notes that OSFI applies a 0% RSF factor to all unencumbered Level 1 assets, regardless of maturity and raises this disparity in treatment to FSRA's attention for consideration.

Regulation is critical to the soundness of financial institutions and to consumer protection. Central 1 recognizes that FSRA strives to strike a balance to achieve sound regulation without disrupting or hindering a system that is functioning prudently and successfully. We believe the feedback we and CUA have provided will assist in achieving that balance and we appreciate FSRA's openness to stakeholder input that contributes to our sector's stability and sustainability.

Thank you again for this opportunity to provide comments. If FSRA seeks further information or discussion on the points above, please contact Alison Thorson, Senior Manager Regulatory Affairs at athorson@central1.com and we will make ourselves available at FSRA's earliest convenience.